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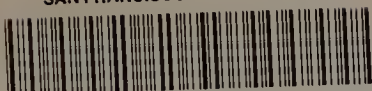
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MODERN CAPITALISM

AND OTHER ADDRESSES

E. H. H. SIMMONS
President, New York Stock Exchange

"Some economic writers during recent years have expressed the fear that capitalism in the United States is now in its flowering stage, and that its speedy and disastrous decline is inevitable. Such a distorted view, I feel sure, must of necessity proceed from a fundamental ignorance of conditions such as we have in the United States today. No one who will view the full panorama of the modern American capitalistic system, with its almost universal benefits, its steadily expanding scope, and its ever increasing achievements, can long remain in doubt concerning its vitality for future years. Never before in history have the needs for capital and the opportunities for capital been as great as they are today. Apart from the pressing problems of restoring prosperity abroad, raising the standard of living in many older nations of the world, and of exploiting the vast new continents which discovery and exploration have so recently opened up, modern capitalism must likewise keep up with the swift and resistless pace of modern science and invention, as they constantly perfect new products useful and desirable to everyone."

E. H. H. Simmons.

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MODERN CAPITALISM

*Address before the Commonwealth Club
of California, at the Palace Hotel,
San Francisco, California,
November 5, 1926*

MODERN CAPITALISM

It gives me genuine pleasure to convey to this financial center on the Pacific Coast, the greetings and good wishes of the principal American financial center on the Atlantic, and to express my deep appreciation for the very whole-hearted welcome which has already been accorded to me here. We all realize, I am sure, the vital need of more complete co-operation between all parts of our great country and all classes of American society, as well as the need for a more adequate understanding by us all of those basic economic principles upon which not only present-day prosperity, but even the whole structure of modern business and government really rests. The rush of unusual events since the war has largely obscured many of these economic fundamentals. Extraordinary experiments in government and finance alike have been made, wholly at variance with traditional ideas. In the confused state of present-day thought, many of us have become highly inconsistent; we are all apt to lapse occasionally into socialistic fallacies of thought in particular cases, although we would violently repudiate socialism as an economic system. In considering the business and governmental problems of today, it therefore behooves us all to return to first principles. In any such attempt to examine modern society and modern economic institutions critically, we at once encounter the problems of modern capitalism, and begin to ask ourselves, "What is capital?"—"Who should own it?"—"To what extent and in what ways should capital be regulated?"

I realize that it has been with some justice that economics has been called "the dismal science." I have no desire to inflict upon you merely abstract and academic considerations, but rather to review

briefly and from the business man's standpoint a few of the leading economic principles regarding modern capitalism as we all encounter them in our own daily lives.

II

┌ We are living in an age and a society based upon capital, and in some ways dominated by it. Inevitably, therefore, we all have genuine convictions and ideas, not only as to how capital should be employed, but also how it should be owned and regulated. Yet few of us, I imagine, often stop to define just what we mean by "capitalism." Certainly, much of the confused thought which one encounters today in regard to the ownership or regulation of capital, springs from inaccurate ideas as to what capital really is.

Capital essentially consists of those things which we obtain by our present exertions, but which, instead of consuming at once, we devote to the future production of wealth. There is no capital which someone did not in the first instance have to preserve from consumption in just this way. All the productive tools of modern civilization are capital. The workman's pick and shovel are capital, no less than the facilities of the largest railway or industrial company in the country. It is true that today the ownership of a great part of the nation's capital is vested in our steadily growing stock corporations, which in turn are owned jointly by hundreds of thousands of individual shareholders. But the method of owning capital does not change or affect its fundamental character, as something saved out of present production to facilitate future production.

X When one realizes what capital really is, the conclusion seems inevitable that as long as we possess any civilization at all, we must continue to have capitalistic problems. Occasionally, it is true, mobs

in brief moments of blind rage, try to destroy capital as such, but such futile attempts are never long continued. Of course we also have dreamers and theorists who sometimes urge us to destroy all our capital and return to a pure state of nature, which they picture as ideal and Utopian. But these would-be abolitionists of capitalism forget that a state of nature is also a state of chronic pestilence, starvation, warfare and savagery, as the study of any primitive race would soon indicate. Even our most destructive thinkers would hesitate to urge upon society the suicidal policy of scrapping and destroying its slowly and painfully acquired capital assets in the form of all its tools and means of production, on any such lunatic basis as this. In fact, even some of our foremost Russian Soviet philosophers, who have so frequently urged the destruction of capital, and who have already dissipated and destroyed so much of the capital of their own country, seem to be curiously interested just at the present time in attempting to borrow the capital of someone else.

We cannot therefore ever hope to solve the complex problems of modern capitalism by the simple method of abolishing capital entirely. Capital will continue to exist; we will always have to deal with it. Thus we come to the next question—should private citizens be allowed to own capital, or should it be owned by the State alone? Here socialism proposes its dizzy theoretical system under which the State should own all the tools of production, on the grounds that such a system is more just and efficient than the private system of owning capital which we have today. During and since the war, indeed, attempts have even been made in some countries actually to try out this wild and impractical proposal, but with results which have been anything but convincing to any reasonable mind. As far as the justice of the private ownership of capital is concerned, it should be realized that only in rare instances can the State create capital, which,

as we have seen, has practically all been brought into existence by the savings of individuals. It therefore appears a matter of elementary logic that our present-day capital should rightly belong to those who have denied themselves to create and accumulate it. But apart from this factor of justice, history has quite definitely proved that the private ownership of capital provides an incentive to create and preserve capital, while the common ownership of capital fails to furnish any such incentive. The individual, whether he lives under a capitalistic or a socialistic State, is always equally tempted to enjoy and consume at once all that he can produce. Private ownership and responsibility succeed in restraining this desire, but there are no similar restraints upon it under socialism. For this reason, when capital is all owned in common, there is no longer any direct responsibility or motive for preserving or increasing it, and every temptation rapidly to dissipate it. Modern communistic Russia, living on the wealth accumulated in the past by the Czars, and for the time being paying its way by exporting its gold supply and other wealth accumulated under the Czars, provides an interesting and illuminating instance of the way capital inevitably commits suicide when its ownership is all entrusted to the State.

Our own experience during the war with State-owned business enterprises, reveals much the same basic tendencies. In the interests of national safety, our government was forced to become the sole owner of several large business enterprises. But this experiment proved an extraordinarily costly and dangerous experience, and we must all for many years pay heavy taxes because of the tremendous government debt which it created. Today many European governments also are rapidly getting out of business, because of their need of economizing and balancing their budgets. An interesting example of just this tendency has been the recent disposal to private

hands of enterprises previously owned by the Italian and Belgian governments. There seems little likelihood that the nations of Europe will, for some time to come, be able to afford the heavy governmental deficits almost invariably created by the State ownership or operation of business enterprises. The result is, that the old socialistic cry for State ownership of productive facilities is today falling on deaf ears, both in this country and abroad. The world's experience during and since the war has afforded overwhelming evidence against such projects. It therefore seems not only reasonable but necessary to conclude, that the private ownership of capital is very manifestly destined to remain the basis of modern society and civilization for many years to come, both in the United States and in the other leading nations of the world.

III

But granted the desirability, if indeed not the absolute necessity, of the private ownership of capital, there remains the further consideration as to how this ownership is distributed through society—whether it is for the most part concentrated in the hands of only a few, or diffused and distributed among all the classes of people. One could quite logically be a strong advocate of private capitalism in general, and still object most strenuously to the undue concentration of its ownership. It is therefore important in any consideration of modern capitalism to consider not only the existing distribution of capital among the people, but also the question as to whether the trend in its ownership is toward a narrow concentration or a wide diffusion. As I have already remarked, so much of our productive capital is now held by corporations, that in consequence the extent to which modern capital is owned by the public at large, can be determined accurately enough by noting the extent to which corpo-

ration shares can be and are distributed among the American people.

There is no doubt that there have been times in the United States when the concentration of security ownership in the hands of a few had reached the danger line. Such instances we all can think of in connection with the railroads after the 70's, and with our large industrial corporations since the 90's. It was almost inevitable that when these new enterprises were first established on a large scale, their creators should for the time being prove their principal security-holders. Indeed, there are many positive advantages for new industries to be owned mainly by leaders capable of taking swift action and assuming enormous risks. Were the concentrated ownership of capital in the early and most dangerous stages of industrial development rigidly prohibited, economic growth and progress itself would be seriously halted.

Nevertheless, as large-scale business enterprises grow older and assume stability, any such extreme concentration in their ownership is no longer needed or justified by the risks to be assumed. Instead ownership by the few tends to become dangerous to everyone, because of its frequent drift toward monopoly, arbitrary price fixing, and unfair restraints upon the freedom of trade—evils of deep significance not merely to business, but to the government itself. It was against the danger of such a development in American business many years ago that that able and courageous statesman, President Theodore Roosevelt, raised his voice in outspoken condemnation of practices in American corporate affairs which business leaders would not think of tolerating today. Indeed, immediately before the outbreak of the European War in 1914, this question of the concentration in the ownership of American capital, especially as it was exhibited in security holdings, was very much to the fore. Although forgotten during the sub-

sequent stress of war conditions, discussions concerning concentrated ownership of American capital were revived with the return of more normal conditions a few years ago. But, rather to the surprise of almost all of us, the problem has very largely solved itself during recent years through the rapid increase of small investors all over this country, and the consequent spread in the ownership of American productive capital.

This development is very remarkable indeed, and I wish to mention a few facts in connection with it. A compilation covering twenty-two large American corporations recently prepared by a leading financial publication, revealed the fact that today 315,497 employees of these companies owned \$455,000,000 worth of stock; the same journal estimates that altogether \$700,000,000 worth of stock in American companies is now owned by their employees in this way. The article goes on to point out that these figures relate only to the companies with definite stock selling plans for their employees, and that the additional consideration of employees who are independently buying shares on their own account would enormously increase this latter figure. But it is not only the employee who is today taking over the ownership of American business enterprises through the purchase of its shares. The small consumer and customer of our leading companies also appear as purchasers of corporate shares to a tremendous extent. In this regard, the most familiar example is, of course, the ownership of the American Telephone & Telegraph Co. by hundreds of thousands of stockholders. Yet this conspicuous example could be paralleled by less-known cases of railway shippers who are now purchasing railway stocks, users of public utilities services who are investing in these enterprises, and buyers from manufacturers and merchandising concerns who are likewise becoming share-partners in them. Indeed, this tendency is

showing itself throughout practically all branches of American business enterprise today, and apparently to a steadily increasing extent.

The significance of the temper and character of modern capitalism in this wider distribution of the ownership in the share-capital of American companies can scarcely be over-estimated. It means that we in the United States are today entering into a new era of capitalism never before experienced in history. We are seeing today a democratization of American industry and American finance alike in this steady tendency of the employee and the consuming public at large to become capitalists in their own right. Earlier examples in history of the wider distribution of capital through the population, have almost invariably been attended by political revolution, class struggles and discriminatory confiscation. But this diffusion in the ownership of capital now going on in this country has occurred through purely peaceful and natural causes. Far from being due to class warfare, or from increasing the likelihood of it in the future, the rise of the entire public as the real capitalist class of our country reduces, if indeed it does not eliminate, the likelihood of class struggles in coming years. It assures a well-founded and stable prosperity for everyone. It is forging a magnificently solid basis from which modern capitalism, as we have it today in the United States, can mount continually to new achievements in the common benefit. At the same time that it proves a salutary check on the existence of over-arbitrary corporate management, and provides a new incentive which labor has never known before, it is also opening to our business enterprises the almost unlimited capital resources of our entire people.

It is not my purpose to attempt here any analysis of the economic forces which are today furthering this broad distribution of capital-ownership among the American public. Yet it is not amiss for me to speak

of the facilities by means of which this broader distribution of American company shares is now taking place. The New York Stock Exchange, while not perhaps a primary cause in the distribution of security ownership, nevertheless provides facilities for it to go on with the maximum readiness, speed, and safety to the investing public. Without the facilities for this steady security distribution provided by the New York Stock Exchange, the widespread ownership of capital could never have become the large factor in this country today that it undoubtedly has. For it has been the New York Stock Exchange which has maintained a free and open market for the leading American securities, and which has rendered this market readily accessible to the whole country through the far-reaching wire systems of its members. The latest and most reliable information obtainable concerning the price and volume of buying in our leading securities is placed at the disposal of the American public by the Stock Exchange tickers with such efficiency, that today New York Stock Exchange quotations are usually available here in San Francisco—some 3,000 miles away from New York—within one minute of the time when they first appear in Wall Street itself. By the listing requirements of the New York Stock Exchange, information concerning the basic value of the same securities is made available to everyone. Due to the floating supply of securities held on loan in New York by security dealers, a ready supply of securities is made available instantly for all purchasers, and at the same time equal facilities are provided for the investor to sell out his security holdings at any time. By standardizing the handling of security purchases and sales, and establishing definite regulations for the business conduct of its members, the Stock Exchange surrounds the process of investment with all possible safety to the investor. Thus it has come about that economic causes, operating through this smooth, dependable and efficient ma-

chinery provided by the New York Stock Exchange—and, I may add, the other similar though smaller stock exchanges of the country—have spread the ownership of the nation's productive capital in the form of shares among all sections of this country and all classes of our people. The very efficiency of American stock exchange machinery has indeed been one reason why we have been so slow in this country to realize the significance of this rapid distribution of our share capital. The Stock Exchange has thus proved not only a facility indispensable to the creation of this new and democratic era in American capitalism, but also a significant assurance of the common benefit to be derived by everyone from the new era of capitalism into which this country is now entering.

IV

In my enthusiasm over the rise of the new American investing and capital owning class, however, I do not wish to appear to be predicting Utopian conditions just around the corner. There are still grave questions which modern capitalism in this country must face without flinching. Even though our leading corporations come to be owned by the whole rank and file of the nation rather than simply by a few capitalists of great wealth, this development is not necessarily any assurance of good corporate management, neither does it remove the problems of capital and its management from the sphere, and possibly the need, of governmental action. It is conceivable that the regulation of capital by the State might still prove a necessity in the interests of its new and numerous owners. For the modern shareholder in most cases is unable to maintain a very close and intimate contact with the actual management of his property. It is true that the shareholder can vote and make his voice heard at company meetings, and also that corporation officials today are

urging the small shareholder to undertake these privileges and responsibilities. Yet I wonder just what would happen if the 85,000 odd common shareholders of the United States Steel Corporation should suddenly decide to attend its annual meeting. Of necessity, a representative form of government has developed in our large companies, whereby the small shareholder gives his proxy quite regularly to the individuals in actual control of company policies. The force of circumstances has made the average company shareholder of today a sort of absentee landlord. A century ago, statesmen used to think that if all citizens were allowed to vote, all the difficulties and problems of government would rapidly disappear. After the experience of the last one hundred years, however, we are today somewhat more sceptical as to the universal truth of this theory than were our forefathers. It may be that we ourselves can similarly be over-optimistic about the effect of wider distribution of company shares on the future problems and difficulties of our business corporations.

Nevertheless it seems obvious that our modern and democratic type of capitalism in this country will not suffer in the future as it has in the past from either government neglect or government persecution. American capitalism in its pioneer stages was undoubtedly a rough and ready affair. The pioneer corporation manager must be forgiven for swimming as best he could, when drowning was so constant a danger. Yet no one desires to see repeated in the future, such common defects of early company management as its foolish attempts at monopoly, cut-throat competition, and arbitrary price fixing. Human nature being what it is, and new industries constantly emerging from this sink-or-swim stage into large-scale operations, it will not do to say that the government should completely ignore corporation management in the future as it used to many years

ago. On the other hand, our more recent experience in this country with the attempted persecution of capital by the government should have convinced us all that this perhaps natural reaction to the preceding policy of "laissez-faire" provides no permanent solution for the question either. It may be a diverting spectacle to assail our large companies in the press unfairly, or to hale them before the bar of justice with bombastic and lurid charges, or to institute a species of economic inquisition wherein the State is at the same time the prosecutor and the judge. Nevertheless little permanent good for anyone is to be attained by such means. However necessary it may be to restrain the unwise or unfair management of capital, it will never do for the State to hamper and inhibit the work which capital can do for us all, and which under reasonable freedom and reasonable management it should do. One of the really fortunate things in connection with modern American capitalism, I feel, is the fact that the mere blind persecution of capital has already proved to be only a passing and temporary phase in the evolution of our economic society. What is needed on the part of the government in its relationship to American capitalism, is a reasonable middle-of-the-road attitude, and this is actually what is evolving today.

Meanwhile, the course of events is providing a new method of solution for the whole complicated problem as to how far the State should attempt to regulate capital as expressed in corporate undertakings. I refer to the tremendous and growing influence of enlightened public opinion, which is an irresistible force when once aroused, and which is fundamental in a representative democracy such as ours, to the State as well as to everyone else. In regard to American corporation affairs, the public must have all the facts and nothing but the facts. In the future, public opinion will prove a decisive factor in any attempt by the State to regulate capital. In consequence, what

is especially needed today, is full information regarding the operations and policies of our corporations, as well as of the foreign governments that are borrowing money of American investors and that are acting as utilizers of this capital in behalf of the people whom they represent. I am persuaded that such full and frank information can be obtained by private means, and that it is not necessary to evoke new and possibly dangerous legislation by the State for this purpose.

If the mystery which so frequently used to surround the large accumulations of American capital has largely lifted today, much of the credit is, of course, due to the vigilance and fearlessness of the American press. Indeed, too much praise cannot be accorded our leading journals for the earnest effort which they have steadily exerted to obtain the truth. Absolute truth is not, of course, always obtained even by scientists—much less by newspaper men under their eternal necessity of getting their paper speedily to press. Mis-statements and even blunders in the account of American business which find their way into the papers, are sometimes unavoidable. Yet even so, the free press of this country is vastly to be preferred to the subservient press which exists in many other countries, and under its natural limitations it is doing a splendid piece of work in bringing the actual and current facts concerning modern capitalism home to the entire reading public of the country.

The New York Stock Exchange has long provided still another source of public information and enlightenment concerning our larger American corporations. It is true that the Stock Exchange is and must be almost exclusively concerned with the investment aspect of corporate affairs, and that it cannot make its pressure felt in many of the problems which involve the other relationships of modern capitalism. Yet the fact remains that the investment aspect of the

modern corporation, having to do as it does with the fundamental health and vitality of our leading business enterprises, is closely connected with these other public relationships of capital today. The influence of the Stock Exchange in this respect is felt primarily in two different ways. For one thing, its listing requirements have in the past been a primary influence in obtaining from the leading American companies current information concerning their balance sheets, earnings, and corporate structure. The New York Stock Exchange has always undertaken this quest for more adequate corporate information entirely in behalf of the public, and it refuses to receive any information which cannot be similarly afforded to the companies' shareholders, and indeed to the public at large. In addition, the New York Stock Exchange is our leading market for capital, and the prices established upon it every day and speedily dispatched to all quarters of the country are dictated in the last analysis by what someone has called the "bloodless justice of the market price." Genuine merit in corporation securities is quickly discovered on the Exchange, while on the other hand any weakness in them becomes apparent with equal facility. As a result, Stock Exchange quotations constitute a sort of daily health report on the current state of modern American capitalism. In regard to this necessity for adequate publicity regarding corporate affairs at the present time, the wide distribution of corporate shares has laid an additional responsibility upon our managers of corporate enterprise. Corporation officials have, in fact, inevitably assumed the position of trustees in respect to the thousands of new security investors whose representatives they are today.

In addition to making publicly available more complete information regarding their operations and affairs, American corporations have, I feel, the further duty of making their statements as intelligible as

possible to the average man. Few individuals today, unless they are experts, can tell what many a corporation or government financial report really means. Public opinion can be led astray in this way almost as much as by the absence of information in the beginning. The New York Stock Exchange has endeavored to do its part in rendering the corporation reports required under its listing procedure, plain and intelligible documents, yet this is in itself a highly difficult undertaking, because of the impossibility of completely standardizing the terms for our widely varying modern industries. If our American company reports and statements are to be shorn of much needless technical verbiage, and much confused grouping and arrangement of the facts contained in them, we must look to the American accountant to assist us and tell us how this may be done. Signs are not lacking, however, that some aggressive American business institutions are themselves perfectly aware of this problem, and are endeavoring to rectify it. Some of our banks are in this respect leading the way by providing the public not only with a full statement of their operations, but with a statement so simply and directly expressed that a school boy should be able to understand it. There is no essential reason why corporation statistics in this country should have the appearance of the inscrutable hieroglyphics on an Egyptian tomb. Most truth is in the last analysis simple enough, if sufficient effort be made to state it simply and to avoid non-essentials.

There is also the whole question of how frequently American corporations should be expected to give the public information concerning their operations. Just as a competent physician must take his patient's temperature at reasonably frequent intervals, so in any intelligent diagnosis of the component corporate units of modern American capitalism, statements should be made frequently as well as accurately

and simply. The New York Stock Exchange in its listing requirements has long urged companies with listed securities to render regular quarterly reports, and although the tendency in this direction is slow, nevertheless it is gratifyingly apparent. It should be realized, however, that the New York Stock Exchange can bring about only a gradual improvement in this respect. No company is compelled to list its securities on the New York Stock Exchange, and if our listing requirements prove a greater disadvantage to our corporations than can be compensated for by the enjoyment of listing privileges, the securities will not be listed and will thus escape any surveillance by the New York Stock Exchange altogether. There are several considerations which, initially at least, are apt to deter a company from agreeing to make quarterly earnings statements. Some companies declare that unless all their competitors would be willing to follow suit, they would be placed at a disadvantage in competition with them. Other concerns, whose business is essentially seasonal, hesitate part of the year to reveal large profits, and at other periods considerable deficits. As time goes on, however these considerations tend more and more to lose their force, and it is my belief that the sound reasons which may deter American corporations from giving frequent statements of their earnings are bound to diminish. In human affairs, a policy which depends on scientific truth alone is sometimes a strenuous and even a disappointing policy. But the position of virtual trustee-ship which the managers of capital are today assuming more and more towards the very numerous small investors who are becoming the owners of capital, will increasingly dictate the need of frequent as well as complete and clear statements as to the statistics of capital itself.

V

Some economic writers during recent years have expressed the fear that capitalism in the United States is now in its flowering stage, and that its speedy and disastrous decline is inevitable. Such a distorted view, I feel sure, must of necessity proceed from a fundamental ignorance of conditions such as we have in the United States today. No one who will view the full panorama of the modern American capitalistic system, with its almost universal benefits, its steadily expanding scope, and its ever increasing achievements, can long remain in doubt concerning its vitality for future years. Never before in history have the needs for capital and the opportunities for capital been as great as they are today. Apart from the pressing problem of restoring prosperity abroad, raising the standard of living in many older nations of the world, and of exploiting the vast new continents which discovery and exploration have so recently opened up, modern capitalism must likewise keep up with the swift and resistless pace of modern science and invention, as they constantly perfect new products useful and desirable to everyone. Economists have long pointed out that there is no limit to the satisfactions which humanity desires, and that in consequence there is at all times an infinite potential demand for goods and services. It seems obvious therefore that we can set no limit upon the productive task with which capitalistic society is and will be confronted, nor scarcely any limits to its ultimate accomplishments.

Certain it is that never before in history has private capitalism been so firmly established as today, and so completely justified by the sharply contrasting collapse of State capitalism elsewhere in the world. Never before in this country has such poise and discretion been exhibited by the government in avoiding either under-regulation or over-regulation of capital. Finally, never before has capitalism included so

many partners, or distributed the benefits of its ownership so broadly throughout our whole people. Modern capitalism is, therefore, no such figure with feet of clay as certain alarmists would have us think. In this country, at least, it never before exhibited such strength and vigor as it does today. I have little desire to attempt to play the dangerous role of prophet concerning the future of modern capitalism. Indeed, because of the complexity of the issues involved, no one can pretend to see this future clearly. Yet it must be apparent to us all that today we are merely entering a new era in which the benefits of the capitalistic system are becoming practically universal, and when the system itself is by force of this fact becoming animated by a spirit of broad and genuine democracy. This final thought should at least justify in our minds a high hope and unshakable confidence, that the world which our children, and our children's children shall presently know, will be better than anything which we ourselves have ever experienced.

AMERICA'S OUTLOOK ON INTERNATIONAL FINANCE

*Address before the New York University
Forum on International Finance in the
Governing Committee Room of the
New York Stock Exchange,
September 23, 1926.*

AMERICA'S OUTLOOK ON INTERNATIONAL FINANCE

It is with particular interest and pleasure that I welcome you to the New York Stock Exchange today, since I have always felt that the founders of this course of addresses and discussions on foreign security investment have deserved the hearty congratulation of the American public, for their admirable endeavors to promote in this country a wider and more thorough knowledge of this highly important subject. Speaking for the New York Stock Exchange, I can assure you of our keen interest in the many practical problems which have arisen from the recent flow of American capital abroad, and our earnest desire to cooperate in effecting a wise and salutary solution of them.

Foreign investment has long since ceased to be a theory—it is a condition with which we are each year more and more completely confronted. To most if not to all of us, it is so recent a development in this country that we realize we have very much to learn about it, and not only the misunderstandings of the public but also of ourselves concerning the subject should tend to be dissipated by the talks and discussions provided by this course.

The investment of American funds abroad is, as a matter of fact, only one of the highly significant manifestations of America's present position as the leading creditor nation of our times. While we should on our part make all efforts to obtain a more adequate knowledge of the conditions and customs of foreign nations whose loans are now gaining currency among our investors, it is no less necessary for us, and for foreign countries as well, to realize clearly those past circumstances which have created and shaped us as

an international lender of capital. It is not amiss, therefore, to call briefly to mind some of the slow processes of our historical evolution as a people, through which our present financial and economic position and viewpoint has been attained.

II

In its earliest days, the United States was a very poor colonial country, far on the fringes of civilization and hemmed in between its long Atlantic shore and the Appalachian Mountains running parallel to it north and south. This mountain chain was not particularly high, yet, save in a few places, it proved singularly impassable for early means of transportation. As a result, the country faced eastward toward Europe in practically all its economic interests. The poverty of its often rocky and inhospitable soil regularly drove its inhabitants to the sea to earn a livelihood. On the water, however, they exhibited much of the adventurous trading instinct of the British mother-country. In the days before steam, ship-building was a great American industry. Already the American mania for speed had become apparent in our clipper-ships. Wharves abounded in every little sea-port town. American sailing masters carried on trade all over the world, and the new flag with its Stars and Stripes was seen on all the seven seas. Despite their small population and their economic immaturity, the United States proved a decided factor on the water. When the North African pirates took to plundering Mediterranean cargoes, they were very promptly made to feel the force of the new United States Navy under Decatur. Perry, another far-wandering American naval commander, succeeded in opening to the trade of the world the island kingdom of Japan, previously a hermit nation. Thus, in these early annals of the United States, a strong tradition for shipping and foreign trade developed.

Suddenly, however, toward the middle of the 19th century, this maritime activity and international outlook vanished. The American merchant marine was slowly abandoned, and the American shipping towns languished, never really to revive. The young men no longer took to the sea. The Stars and Stripes practically vanished, not only from distant oceans, but almost from the Atlantic as well. Abandoning the seaways, the United States turned its face to the western wilderness.

This transformation, still so perplexing to Europe in some of its present day consequences, was occasioned by a major historical happening—the successful westward passage of our Appalachian Mountain chain by the steam railroad. Almost at a stroke the old coastal settlements along the Atlantic were placed within easy access of what were perhaps the richest agricultural and mineral lands in the world. It is therefore little wonder that America abandoned the seaways for the landways, and that the energy of our people was diverted from roaming the seas to colonizing the wilderness. The whole country suddenly faced the west, and became immersed in a new and vast internal conquest.

It is well, if we are to grasp the full significance of the last hundred years of American history, that we attempt to visualize the tremendous task undertaken by the early American pathfinders and pioneers. From the summits of the Appalachian Mountain chain there stretched away to the westward an enormous valley, extending some 2,000 miles to the Rocky Mountains and the Pacific Coast, and an equivalent distance from the Great Lakes to the Gulf of Mexico. This vast valley area of fertile plain and virgin forest, the heart of the whole North American continent, was a region of incalculable potential wealth. Excepting Russia, the whole continent of Europe could be without difficulty placed inside its tremendous interior reaches. The penetration of this

primeval region by the steam railroad at once imposed upon the American people the task of colonizing and bringing under one governmental control this enormous area.

With the perspective of almost a century, the proportions of this task seem even greater. No nation in history had ever faced so colossal a land problem, save perhaps Russia in her Siberian provinces—and in this latter case, as events have proved, the central government has largely collapsed under the strain of controlling its tremendous land areas. The American frontier, moving steadily westward, has almost exclusively absorbed our national attention. It has frequently dominated our political and economic aspirations. To understand the present day United States without considering its tremendous program for internal development, would be to cast Hamlet without the melancholy Dane. To an overwhelming extent the United States is today what the Mississippi Valley has made it. Not until our great western agricultural regions were established was the idea of wealth in the European sense frequently associated with the United States. It has been from this great central valley that most of our national wealth and prosperity has been continually drawn.

Until our own times, only once has our vast internal problem of colonizing the great valley been seriously menaced by war. Our Civil War—so remote to the interests and pre-occupations of Europe at the time—proved a tremendous and lasting tragedy to us. After the Civil War the United States was left shaken and disrupted to resume its former labors of internal development. And again this national effort called upon all the potential abilities and energies of our people. The Franco-Prussian War, of such profound significance to Europe, was to us only the muttering of a thunderstorm on the far horizon. So, too, it was with later conflicts and diplomatic crises abroad. The task of driving the

iron pathway of the steam locomotive through the great valley and over the Rocky Mountains to the Pacific Coast, was too absorbing a task for us, to allow us to comprehend the significance of the balance of power system developing in Europe.

During the latter half of the 19th century, however, our British cousins had a vastly better understanding of our problems than we had of theirs. British capital investments in our railroad and other enterprises assumed enormous proportions. What sea routes and shipping were to the British, our railway lines were to us. Without the railways, our Federal Government could not in all probability have successfully exerted control over our vast interior areas. The British philosopher Edmund Burke had despaired of the ability of the royal government of his time successfully to exercise control over North America. He in fact drew a vivid picture of our great valley populated only by roaming and nomad peoples of white race, yet scarcely more civilized than the original red inhabitants. In the early days of the American republic, Washington and our other leading statesmen were equally baffled by the same problem. Thus it came that the epoch-making invention of the steam locomotive followed swiftly by the large scale investments in railroad securities, and the development of an active market for these securities on the Stock Exchanges of London and New York, proved one of the indispensable factors in our rapid national growth. Railway building, a necessary step in colonizing and settling new lands, naturally became one of our major preoccupations almost throughout the 19th century. Financial panic after panic in the United States was caused by our constant speculative tendency to over-build our railway facilities. Nevertheless by means of this financial speculation in railway securities on both sides of the Atlantic, the physical foundations for the political and economic United States of our times were laid.

At the turn of the century in 1900, however, there were manifested for the first time signs that a new economic era in the United States was at hand. In fact we experienced at that time a sort of false dawn as a creditor nation. The conclusion of the Spanish War left us with new colonies in both the Atlantic and Pacific, and the difficulties of a new colonial policy to distract us and draw our eyes outward from our traditional problems of internal growth. At the same time heavy gold imports and other unusual circumstances led to a marked though temporary financial prosperity, and even to some investment by Americans in European securities. Yet the few foreign securities which at that time came to be listed on the New York Stock Exchange, possessed to us a strange and somewhat paradoxical air. The United States was still in reality a debtor nation, and was still dependent upon European capital for its own continued development. Our sharp financial panic in 1907 conclusively proved this fact, and by exposing our financial insufficiency led to the creation of a vastly stronger mechanism of finance in both the American banking and security markets.

Nevertheless the pioneer age in America was rapidly passing. The principal railway lines were laid at last, and by 1910 the American railway net attained its maximum mileage. There were other similar signs such as that afforded in the west, where the wheat farms were rapidly absorbing the cattle ranches. Thus it came about that at the outbreak of the Great War in Europe, the United States found itself able to care for its own financial needs, and after a few years to lend a surplus of its capital abroad to others. Had the European War occurred ten or twenty years earlier, the ability of the United States to play a significant part in it financially, would have been vastly more doubtful.

It was inevitable that sooner or later the United States would have become a great creditor nation.

The practical effects of the war have therefore been to force within a brief period, an economic development in the United States which under other circumstances might well have required a half century or more. And this profound and tremendous significant transformation of the international economic status of the United States has come suddenly upon a nation almost wholly unprepared for it by experience, economic interest, or traditional outlook.

It has often been said that until the World War, the United States lacked an international outlook, and under the circumstances of our own striking internal growth, this was inevitable. The great bulk of Americans knew and understood very little concerning Europe. From their school geographies they had perhaps gathered that Great Britain was an island, that Italy was a peninsula shaped like a boot. Yet of the complex social, economic and political establishments of Europe, or of the European historic background, there was little or no real comprehension.

But during the war millions of our young men for the first time set foot upon foreign shores, and today these first-hand witnesses are spreading through countless little towns and villages throughout the heart of the United States a knowledge of other lands and other customs, with undoubted economic and financial consequences for the future. In these latter years, travel abroad has in the United States become no longer a luxury, but a commonplace. Moreover, owing to the continued advance of scientific invention, the world's distances have perceptibly shrunk through the spread of the radio, air navigation and other new and striking facilities for transportation and communication.

The present is therefore an age of transition, no less in the United States than in Europe. America is at the crossroads of a momentous change in her economic policies and interests. Her great internal task

of colonization and development is by no means finished, nor will it probably be for yet some generations. Nevertheless the United States is once again facing outwards. The century-old spell of absorption in settling our great valley is not yet altogether broken, nevertheless it is mingled with a broader vision of the modern world, and a wider realization of the part which the United States must play in it. This viewpoint, so natural and traditional to Europe, means with us the reversal of habits of thought and custom which have dominated us for almost one hundred years. Such shifts in national viewpoints take time.

Exactly what part the United States will play in the world of to-morrow depends on the collective wisdom of Europe as well as on our own. Surely if material prosperity is any necessary basis for this, the United States should fulfill a constructive role as creditor nation in the coming years. Under an unyielding regime of Federal economy so constantly maintained by President Coolidge and his able Secretary of the Treasury, Mr. Mellon, the economic burdens of war in the United States are rapidly being abated, and taxation here is steadily lightening. Had a less courageous and wise attitude regarding our government financing been undertaken after the war, the United States would by no means be in the sound financial condition which it at present enjoys.

Yet the role of creditor nation is still very new to us, nor have we had time to learn much about it, in the intense haste and pressure of the past unprecedented ten years. So far as sound foreign securities can be floated and sold in the United States, the process should serve to facilitate the composure of the difficult financial problems of many European governments, to provide European industries with much equipment and materials, and serve to restore in Europe as satisfactory conditions to the average man—and perhaps in time even more satisfactory

conditions—than those which obtained before 1914. It is particularly necessary, I feel, for America to benefit in this work by the longer and ampler experience of the creditor nations of Europe—particularly, of course, that of Great Britain.

Already there has been extensive investment by small American investors in foreign government bonds, which has proved a very constructive and stabilizing factor to Continental nations. In the United States, our large government war loan flotations tremendously broadened the investing public by creating a new class of security buyers. These new investors need the maximum protection which organized finance can throw about them, and in the United States much financial technique of a new order is needed to further such a policy. The American investor has already ceased to be a supporter only of the American government and American business enterprise. Properly led and properly safeguarded in his investments, he can exert an even wider and more constructive influence in the restoration of economic prosperity abroad.

III

One common experience has resulted from the recent war both here and abroad—the definite proof and general realization of the permanent character of our modern financial system of credit, and in fact of the entire present system of private capitalism. In the days before 1914, we were frequently told by numerous learned gentlemen that warfare under modern conditions had become an impossibility, because of the appalling shock which it would impart to the credit machinery of the modern world. The element of truth in these assertions we have witnessed in the extraordinary conditions produced in financial centers on both sides of the Atlantic during the past ten years. Yet to-day the financial machinery of the creditor countries of the world

is again being actively appealed to, in the effort to restore the world, and this machinery is moving constructively to accomplish this task. If modern capitalism in Europe and America can survive such a war as has recently been concluded, its ability to sustain the lesser shocks and burdens of normal peace times need give little concern in the future to any reasonable man.

The war has likewise conveyed a similar and even more significant lesson regarding the modern system of private capitalism. Before and even after the war, there has been much glib talk concerning the Utopian character of state socialism, and until recently it was difficult to definitely disprove such easy prophecies, because no country had ever been foolish enough to attempt to realize them. The war forced a condition of government control everywhere, and a considerable chance to observe its much-heralded benefits to the average man. Yet now, not only Britain and the United States but many other countries with a less distinctive tradition toward freedom, are striving to restore the private initiative of pre-war days which our recent experience has shown us to be so necessary a factor in actual economic achievement. Civilization will in the future always have the supremely practical benefit of the Russian example, as an object lesson to casual and uninformed critics of private capitalism. Indeed, the great nations of the present world owe a profound debt to Russia for providing civilization with a permanent example of the fallacious follies of state socialism and complete government control of trade and industry.

Thus, in point of fact, private capitalism has experienced its supreme test during and after the recent war, and by its tenacious ability to survive and function has secured its greatest triumph. The practical task now summoning us, is to effect a closer partnership between modern capitalism and the con-

tinued discoveries of modern science, to build patiently and steadily a better world.

In my own case, I can of course speak with a greater degree of assurance in these matters in connection with the capital markets on our stock exchanges, which are so fundamentally necessary in the modern system of private capitalism. During the war, the securities market on the New York Stock Exchange was of necessity curtailed in many ways by a policy of government control. But with the passing of war conditions, the old dependence upon private initiative rather than governmental administration or political regulation, has very conspicuously and completely revived. We have, in keeping with what may be called the Anglo-Saxon genius for private initiative in business affairs, always been skeptical of any bureaucratic administration of our commercial and financial affairs by our government. We have instead always adhered to the idea of a free and open securities market, untrammelled, as far as possible, by hampering legislation, and dependent for its value and usefulness upon the responsibility and fairness of free citizens. The enlightened attitude of our Federal and State legislation in this matter, as well as the similar wisdom of our courts, has permitted the organized security markets on the New York Stock Exchange under freedom to expand its sphere of usefulness, within the limitations of purely economic considerations.

Undoubtedly much remains still to be done to distribute the full benefits of modern private capitalism to everyone. In recent years, we have experienced a remarkable increase in the number of our security investors as a result of our war loans and the publicity attending them, and a remarkable diffusion of the ownership of our large corporations. The increasing tendency in this direction has already brought with it a gratifying improvement in public opinion concerning the relations of government and

business. Here, as I see the matter, is the means for a healthy democratization of security markets and finance itself, which should be safeguarded and fostered in all possible ways by financial men.

Probably the most threatening menace to the wider diffusion of security ownership, at least in the United States, consists in the highly dangerous activity of security swindlers. Security swindling, I have come to believe, is to a considerable extent an international evil. The professional swindlers of America are becoming accustomed to pursue their activities abroad, and in our financial centers swindlers from foreign countries also occasionally operate. Concerted action by the the leading financial centers of the world in this matter might accomplish very genuine and permanent benefits to our security holders, and provide everywhere safer surrounding circumstances for the vital work of garnering private capital through our various financial systems for constructive use. The financial systems of Europe and America, so different in superficial aspects and so profoundly alike in fundamentals, have already done yeoman service during the past ten years in repairing the wastage of the war. It is my hope that by a closer co-operation they can cherish and provide for the future the safety which should surround the indispensable flow of private funds here and abroad into the creative work of reconstruction.

IV

To-day there is perhaps a more widespread and calm consideration of the possibilities of future years than ever before in history—a natural result of the unprecedented events which have occurred since the outbreak of the war, and the changes which have already been seen throughout civilization. I am no philosopher or scientist, nor can I even lay claim to being an observer of the significant tendencies now

operating in the modern world, with a knowledge and judgment comparable to their complexity and immensity. Nevertheless, close acquaintanceship with a great security market forces certain conclusions upon any one, since there perhaps the real forces of our modern world are most sensitively and broadly manifested.

We are all living to-day in a great scientific age, when the announcement of new discoveries and inventions crowd fast upon each others' heels, and when new methods and devices are pouring rapidly from our laboratories and workshops to be placed swiftly at the service of mankind. Let us make no mistake about the matter—this scientific progress can not be halted even by so appalling an episode as a world war. Indeed the signs multiply, that it is already accelerating. It has behind it the momentum of an astonishing century, and its ultimate significance no man can surely foretell. The march of armed men is after all not impressive beside the march of science. Nature covers with surprising quickness the scars of the battlefields, and even the ache of human loss fades with the passage of time. Meanwhile, science is providing a new release of energy and hope everywhere throughout civilization. Neither the statesman nor the business man can afford to face the future with a closed mind.

There has never been a time in the world's history when the progress of science has been so rapid, or the creation of wealth so widely facilitated and so swiftly rendered possible. This is not any chance rhetoric, nor merely the expression of an easy-going optimism. Just as the burdens and scars of the great Napoleonic wars a century ago were paid off by the inventions of Arkwright and Whitney, so too, I believe, the consequences of the latest world war will be met and liquidated by the continued advance of scientific knowledge and mechanical ingenuity. Thus scientific discovery holds forth a bright hope to the

life of everyone to-day, of a broader and better existence for us all.

As practical men, however, it is not so important for us to concern ourselves with mere prophesies of better things to come, as it is with how their arrival can best be facilitated. Spencer once defined life as "the continuous adjustment of internal relations to external conditions." Even in the fluid civilization of the United States, many of our ways of life will never return in the exact form with which we were familiar before the war. Even under conditions of long future peace it must be expected that the changing external conditions created by the advance of science will demand a continuous adjustment of our internal relations to them. It is inevitable that the dynamic urge of scientific discovery, halted for a brief space by the war, is destined to become more and more forceful and intent. And meanwhile there is placed upon financial leadership a need of constant alertness in adapting our financial machinery and our financial methods to the great work of financing a more useful and productive industrial establishment. There has probably never been a time before when there existed so great an actual and potential need of capital as to-day, and in consequence the opportunities for the investment of capital in our own times provide not only the proper incentive of private profit, but also the more significant possibility of a broader human service. In the coming years there is a great work for modern finance to do, and especially in the free markets of London and New York a stirring opportunity and a deep responsibility must be faced.

So it is that I return to my original thesis—the great need to-day of a closer acquaintanceship and a deeper mutual understanding between American and foreign trade and finance—not only as a pleasure and facility to ourselves, but as a duty to the future of our own countries, and indeed that of the world.

Too long have the commercial and financial relationships of modern countries been popularly considered merely as a fertile source of wars. Certain impetuous critics have so far pursued what is called the "economic interpretation of history," that they are continually agitated lest with every trade dispute and every instance of commercial competition, we should at a moment's notice fly at each others' throats. We all well know what nonsense such a jaundiced view of history really is, and both here and abroad we should take it upon ourselves more actively than perhaps we have, to establish the fact more widely. For international trade and the international contacts furthered by modern finance, when rightly considered, can be and long actually have been, a solvent for international misunderstandings and disputes of all sorts. The merchant and the banker have long proved very potent ambassadors of peace, and have frequently exerted restraint upon the narrow tendency toward self-glorification to which all peoples are in varying degrees subject, and which has so frequently proved a check and hindrance upon the world's progress.

Recently there has been much rather futile discussion concerning the primacy of the financial centers of London and New York. But I confess that I am not very deeply interested in the question of which is larger or greater than the other. I am more concerned that both London and New York, as well as the other leading financial centres of to-day, should work in a closer partnership than ever before to provide a more effective financial leadership in the modern world. There are very great common tasks which to-day lie ahead of us all—the restoration of sound and honest currencies everywhere, the elimination of the needless instabilities of trade and credit alike, and the establishment of strong and enduring foundations for a wider diffusion of wealth, and a higher type of civilization in the days to come.

SPECULATION AND THE STOCK EXCHANGES

*Address delivered at the Annual Dinner
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Detroit, Michigan,
January 6, 1927*

SPECULATION AND THE STOCK EXCHANGES

It goes without saying that I deeply appreciate this opportunity of visiting Detroit. Not the least indication, I am sure, of Detroit's remarkable development as one of the leading metropolitan centers of the country, lies in the fact that you have here an enterprising and well-conducted stock exchange. Apart from the splendid hospitality of your business leaders, this fact is a real assistance in making a sojourner from Wall Street like myself feel entirely at home here.

It has long been the rule that the more prosperous any city becomes, the more apt it is to possess a stock exchange of its own. Today there are over two hundred stock exchanges in the world, located in every country where modern business and financial enterprise exists. Even in Oriental countries like India, Japan and China, the need of organized security markets has been sufficiently pressing to have resulted in the establishment of stock exchanges. In the United States, of course, we have some twenty-five separate stock exchanges in our leading business cities already. Naturally, this fact is most reassuring to those of us in the Atlantic coastal cities whose stock exchanges have so often been subject to misapprehension and misunderstanding. It means that as far as there are problems today arising from the operations of organized security markets, these are no longer merely local or sectional matters, but they involve all the heavily populated sections of our country. In discussing with you certain of these problems of the modern stock exchange here today, I know that I am not importing essentially New York questions into the West, but that I am dealing

with questions in which Detroit, as well as New York, has a direct and kindred interest.

Stock exchanges have been criticized on many different scores, both real and imaginary. One of the commonest criticisms is the charge that they foster and create speculation in securities. Indeed, I have sometimes been informed by earnest but rather casual students of the subject, that a stock exchange would be an admirable sort of organization if it would only confine itself to investment purchases and sales, and that the speculative business in securities, being an unmitigated evil, should somehow be removed from stock exchange operations. Those of us who have had a practical rather than a purely theoretical contact with the subject of security speculation, however, realize that it cannot be settled in any such outright and wholesale fashion. Before condemning security speculation purely on the basis of preconceived ideas or subconscious prejudices, therefore, it is necessary for us to consider a little more deeply just what security speculation really is, and just what function or functions it actually plays in our modern business world.

II

Perhaps the main difficulty in discussing the old subject of speculation intelligently and fairly, arises from the fact that few of us have any clear or accurate definition of speculation. Indeed, few economic terms have ever been used so carelessly and vaguely as this. Surely, until we get a good working definition of speculation, our attitude toward the subject must always be based on theory or mere emotion, rather than on concrete facts. It is particularly important to distinguish at the outset between speculation and gambling, which are so frequently and so erroneously confused.]

In this matter of defining speculation, the dictionaries are of little help to us; they give us many very

different definitions and leave the matter in the air. Nor are most of our economists of much more practical assistance in the matter. Some economists say that speculation is a subjective thing—that it consists in foresight as applied to future developments, while gambling consists in a mere blind and ignorant acceptance of risks. A moment's reflection, however, should show the fallacy of such a definition of speculation and gambling. For the mere betting on future events, such as wagers placed on horse races or prize fights, can be attended by considerable foresight, while obviously legitimate business transactions can be and frequently are entered into without any particular intelligence. We may say that successful gamblers and successful speculators as a rule employ study and foresight, while unsuccessful gamblers and unsuccessful speculators are apt to use neither. As a result, one cannot hope to distinguish speculators from gamblers by the test of whether they did or did not employ foresight and intelligence.

Other economists sometimes base their distinction between gambling and speculation upon the intent of the individual. But this, when analyzed, is an even more ridiculous proposition. For if the individual cannot clearly distinguish speculation from gambling, it makes no particular difference whether he intends to speculate or intends to gamble. For he may intend to speculate but actually gamble, or he may intend to gamble but actually speculate. As long as the definition of speculation depends upon such vague fallacies as these, discussion of the subject gets nowhere, and ends in a mere fog of meaningless words.

Actually, the distinction between speculation and gambling is definite and clear-cut. It is not a matter of what a man intends to do, but what he actually does. Speculation consists in buying or selling property with the purpose of making a profit between

the purchase and selling prices, and meanwhile accepting the inevitable risks which attend such an operation. Gambling, on the other hand, consists in wagering sums of money on some future fortuitous event, without any necessary relation to the acquisition or disposal of property. This is the essential distinction between speculation and gambling, which has in most cases been adhered to in the law, and it is perfectly sound from an economic standpoint. Superficially, of course, speculation and gambling seem very much alike. Both processes involve the assumption of risks in the hope of making profits. But the risks assumed in speculation are the inherent risks attending the ownership of property. They are not risks artificially trumped up or created, but already existing in the nature of things. On the other hand, the risks of gambling are unnecessary and artificial risks, which are created simply for the purpose of deciding wagers of money.

It should therefore be obvious that gambling could readily be done away with, since it plays no necessary part in the ordinary processes of trade. But, on the other hand, speculation is an inseparable, integral and indeed indispensable feature of all trade. Whenever anyone buys or sells property of any description, he is necessarily to some extent speculating. To undertake to abolish speculation is therefore an impossible and Utopian project, and so indeed it has proved throughout the history of all modern countries, and of ancient nations also.]

III

I have ventured to call your attention to the fact that speculation involves the assumption of an inherent risk arising from the ownership of property. When we go one step further and ask ourselves why it is that the ownership of property should involve as much risk as it obviously does today, we encoun-

ter the further fact that all values of property are constantly subject to change. There is no such thing in the world as a form of property whose value never changes. And it is also true that we human beings can foresee and anticipate these constant changes in the value of property only occasionally and imperfectly. Sometimes we read statements regarding American business life which stress its mechanical character. As a matter of fact, every practical business man knows that the conduct of any business involves a constant struggle with a perfect maze of uncertainty, over which even the ablest men can exert only a slight degree of foresight and control. No one would ever dream of walking into the office of one of your leading Detroit motor manufacturers, and telling him that his business was without risk and uncertainty. The Detroit business community is supposed to know more about the automobile business than any group of people in the world, and yet I will venture the opinion that if the question was raised as to what the motor industry will be like ten years from now, one would obtain almost as many different answers to the question as there are automobile executives in this city.

The peculiar thing is, that although practically everyone realizes the importance of this element of risk and uncertainty in the practical conduct of business affairs, so few people apparently appreciate its necessary relationship to the constantly changing values of security prices on the stock exchanges. The risks and uncertainties in modern manufacturing necessarily have to be imparted to the securities of manufacturing companies quoted on the exchanges. As long as the modern business itself fluctuates, the securities of the modern business must also fluctuate. As long as there will be speculation in the business itself, so long also there must be speculation in securities of the business. Indeed,

speculation in securities is simply an effect, not a cause, of the speculative tides which constantly sweep through our whole business world.

It would be difficult enough if business men, whether dealers in automobiles or dealers in automobile securities, had to contend only with the risks and uncertainties arising from natural events, such as earthquakes, hurricanes or weather conditions. But in addition to these unpredictable events causing risk and uncertainty in business, we all have to contend with the rapid changes in business affairs which progress itself is constantly causing. Whenever a new invention is established, an old process must be scrapped and written off. Progress in business affairs is consequently destructive as well as constructive. When the motor car became popularized, the bicycle companies and horse-drawn vehicle makers fared badly. It may be that twenty years from now air transportation may render the motor business in part obsolete. If we are to have progress—and I think that none of us would urge on this score that scientific discoveries and inventions should be halted—we must pay the inevitable price of progress. In any case, progress is bound to involve constant risks and uncertainties in all business, and, since someone must assume and bear these risks, to make speculation in all forms of property inevitable.

This matter of progress in discovery and invention has of course, a very immediate bearing on as dynamic and enterprising a community as the city of Detroit. In your great manufacturing establishments here, new inventions are nothing exceptional—they are constantly and incessantly being made, and few of us as yet can see any necessary limit to this process. As long as this furious and amazing rate of discovery and invention is continued, its speculative effects on the value of all kinds of property throughout the country, and indeed throughout the world, are bound to be far-reaching and un-

ceasing. So true is this fact, that when speculation in securities on the stock exchanges is condemned, I have been sometimes minded to point out that much of it has basically been due to the energy and enterprise of Detroit and other American manufacturing centers.

I by no means wish to convey the idea that I am advocating any curtailment of American mechanical inventions. I have personally never been frightened at the rapid progress which American industry has been making so conspicuously in recent years. Such progress is an obviously good thing. It can easily be demonstrated that in the long run everyone is better off because of it. But it is also, as I said, necessary to recognize that such progress means constant change, and the imposition of new risks and uncertainties in business, which in turn occasion speculation not only in business itself, but in the stocks and bonds which represent the invested capital of business. If, therefore, speculation in securities is to be condemned, it will be necessary to include in the indictment all business progress and invention as well.

IV

Thus far, I have spoken of speculation as an abstract and impersonal economic force which pervades to a greater or lesser degree the entire field of American production and distribution, and which is an inevitable and integral part of them. Speculation, however, in securities, as well as in all other forms of property, has its personal and individual aspect. Even though speculation must continue as long as we are a modern, prosperous and progressive nation, it by no means follows that all individuals are equally suited to engage in speculative business. Here as in so many other questions of individual conduct, the individual must establish his own rules in the matter and set his own standards. A man is, of

course, very foolish to engage in speculative operations, whether in securities or in any other form of property, when he cannot afford the financial losses which the risks of such transactions almost invariably make possible. Speculation is a most useful and necessary servant, but a very bad master. When an individual who lacks balance and a proper sense of proportion and responsibility engages in speculative transactions, he may substitute mere recklessness for the steady and constructive work which the economic order requires. But to argue that because such individuals are injured by the speculative operations in which they have engaged, speculation itself should somehow be abolished by a process of law, is no more reasonable than to argue that no city should be allowed to maintain a reservoir, lest some individual might tumble into it and drown himself. It is sometimes a convenient excuse for the man who has experienced heavy speculative losses to attempt to lay the blame for them on the basic principles of trade itself, rather than upon his own recklessness and folly.

In this connection, it is highly important to understand very clearly the actual relationship that exists between the stock exchanges and speculation. Speculation was by no means created by stock exchanges. There was speculation for hundreds of years in all manner of property before any exchange of the modern type had been established. Moreover, speculation goes on every day in commodities like real estate for which there is no organized market or exchange, and also in securities which are not admitted to dealings in the existing stock exchanges. On the other hand, it may be said in part that it has been speculation which has created the necessity for organized exchange markets, to regulate and handle the business in an orderly, equitable and systematic manner. In consequence, the stock exchanges neither approve nor disapprove of specula-

tion as such. They simply recognize that speculation is an inevitable and omni-present economic force, that it performs an absolutely vital economic function, and that speculative transactions in the exchanges must be handled, and handled in an adequate way, if the exchanges are to serve a useful business purpose.

This leads me to still another point which has frequently been misunderstood. Even if one believes that speculation in securities performs no valuable economic functions and should somehow be prohibited by law, it does absolutely no good, and on the other hand, infinite harm, to attempt to put speculation out of existence simply by hampering and crippling the organized markets where business is handled: Such an alleged remedy always fails to get at the root of the matter. Speculation of necessity will go on. If it is prohibited on the stock exchanges, through which it can be to so large a degree properly regulated and controlled, it will simply be driven into private and unorganized markets where any such regulation and control are absolutely impossible. Throughout the history of legislation in all modern countries, the only effect of hampering stock exchanges to prevent speculation has been to aggravate whatever disorder already existed, and to set up a remedy which proved worse than the original complaint.

It is one of the important functions of a stock exchange to give the fullest publicity to all the transactions which occur upon it. In this country, the perfection of the stock ticker system permits of the almost instantaneous printing of all open market transactions on the New York Stock Exchange in every part of the country. If there is anything irregular or peculiar in these transactions, the whole nation is informed of the matter at once. Owing to this system, sometimes undesirable transactions in the security markets are brought out into the open where

they can be analyzed and subjected to the reaction of public opinion throughout the country. This is an obviously great service which the Stock Exchange renders to the public, and it is very shortsighted indeed to condemn the Stock Exchange itself for the occasionally irregular transactions occurring in its market. For if it were not for the Stock Exchange, evils in the securities markets of the country would in most cases go on undetected and uncondemned, nor could public opinion, and also the force of the law, be speedily mobilized to correct them. If the conditions in the American securities markets are to be steadily improved, the way to go about such a task is to utilize the tested machinery for this purpose already established by the stock exchanges themselves, rather than to attempt to wreck this machinery and then find oneself without the tools needed to effect genuine improvement and reform.

This point of view is no mere theory, formulated by the stock exchanges in their own behalf. The whole matter has had a practical demonstration in Germany, the results of which should convince any fair-minded critic of stock exchange administration. In fact, national German laws were enacted in 1896 which had for their purpose the driving of speculative business from the German stock exchanges. The laws, until their repeal in 1909, succeeded in seriously crippling the stock exchanges of Germany as free and open markets for the transaction of the public's business in securities. But as far as speculation in securities was concerned, it was simply driven from the stock exchanges, where it could be intelligently regulated and controlled, into private and unorganized markets where such control was impossible. Much of the business was also driven from Germany into the great organized markets in other neighboring countries—particularly, perhaps, to the great financial markets of London. After the futility of these laws had, over a period of years,

become obvious to everyone, they were repealed. But the harm which the whole nation sustained in thus crippling its organized markets, was not so easily remedied, and there is reason to believe that during the severe strain of the war period, one of Germany's greatest handicaps was the lack of free and untrammelled organized markets, which—fortunately for us—had been maintained in England, France and other of the Allied countries.

If further evidence were needed as to the necessity of free and speculative markets for securities and other kinds of staple property, it has been very definitely supplied by Russia under the Bolsheviks. Recently, the great Russian writer, Maxim Gorky, has stated that Russia has become the guinea pig of modern economic theories. Just as modern medicine has experimented with different germs and microbes on the inoffensive guinea pig, just so the gentlemen of radical economic beliefs have infected the body of Russia with all manner of economic fallacies and heresies in our own time. The Communist leader, Lenin, started with the fallacious theory that all speculation was unnecessary and should be absolutely prohibited. It is perhaps to the credit of Lenin that he is the only legislator on record who has made a consistent and logical attempt to do away with all speculation. But the result of his economic experiments on Russia in this regard nearly hurled the entire country a thousand years backward into savagery and barbarity. In one of the richest agricultural sections of the world, the Russian peasants starved to death by millions. Pestilence on a scale almost unknown in modern times spread throughout the country. Since this rash and terrible experiment, the Soviets have been compelled to admit in practice the necessity of speculative trading, although in theory they still make violent speeches against it. After this laboratory experiment in economics on so extensive a scale and with such incon-

trovertible results, the advocates of prohibiting speculative trading by law in almost any kind of property, are destined to have a hard time of it in coming years, if their appeal is to have any relationship to logical reason or practical experience.

It is therefore true that the only way of actually improving the conditions which attend speculation in trade, is the slow but sure method of scientific research, steady publicity and public education in economic affairs. I have already alluded to the fact that speculation necessarily arose out of uncertainty, and only as our increasing knowledge of the economic world in which we live can reduce the uncertainty which surrounds business life, can speculation be diminished in volume and in intensity.

V

I confess that it seems scarcely necessary for me to argue in the City of Detroit, the tremendous value and necessity in modern business of scientific research, and definite and specific educational work. In recent years there has been in this country a tremendous development along these lines, not only in manufacturing and merchandising, but also in finance. I desire only to point out a few examples along this line, of the work which the New York Stock Exchange has done and is doing. Through the listing requirements of the New York Stock Exchange, corporations and even governments which desire to have their securities admitted to dealings, must agree to make available to the public of this country definite and specific figures relating to their financial position. From this source, there is growing up a most valuable body of financial data on the leading business enterprises of the day, as well as of some of the foreign debtor governments, which is of the greatest value to the scientific study of investment problems. The listing requirements of the

New York Stock Exchange are, of course, nothing new, but in recent years they have been expanded in important particulars, especially perhaps by the requirements for foreign government bond issues, established two years ago.

Another effect of kindred character has been the improvement brought about in our ticker service. The New York Stock Exchange is in fact the only great stock exchange in the world which today places before investors not only all prices on open market transactions, but also the volume of such transactions. It goes without saying that as the security issues listed on the New York Stock Exchange increase, and the volume of trading in these securities also grows, many different problems arise in maintaining this instantaneous nation-wide service. The Exchange has already effected very great improvements on its former ticker system, and it stands ready to make such further improvements in it as the practical requirements of the security business, and the new facilities made available by scientific invention, will permit.

Sometime ago the Stock Exchange undertook serious economic and statistical research work, as one result of which it is the only great stock exchange in the world today which knows definitely the nominal and market value of its listed securities each month throughout the year—statistical data which is, of course, a necessary yardstick for the scientific measurement of Stock Exchange operations of almost all descriptions. Undoubtedly the greatest innovation in regard to the information which the New York Stock Exchange today makes available to the public, is the publication each month of the total money being borrowed in New York on security collateral by its members. These Stock Exchange member loan figures, which are without doubt familiar enough by this time to many of you, have in my opinion already served as an important

stabilizing factor in the securities markets themselves. For the first time, not only bankers and stockbrokers, but also all American security dealers and investors are simultaneously informed regarding the amount of money currently employed in carrying on security distribution. Changes in these figures from month to month can today be taken carefully into consideration by anyone in the country who has reason to be interested in them, and the former uncertainty regarding the amount of such loans, which was in itself to some extent a necessary cause of speculation, has largely been replaced by definite information and the public confidence always engendered by an open presentation of definite facts and figures. The exact significance of these new loan statistics is a subject which will in future years call for careful study and analysis by our best financial economists. Hasty and unfounded assumptions regarding them are of course to be deprecated. But it is my feeling that these important statistics provide a very good example of the only real method of improving speculative conditions in our organized markets—namely, by a process of open publicity and popular education which in this instance has already demonstrated its undoubted merits.

I might perhaps mention one other phase of the New York Stock Exchange endeavors along this particular line. This year, careful and comprehensive studies of the leading European stock exchanges were undertaken by our Exchange, in order to place at its disposal the experience which other nations and other markets have had in stock exchange administration. I feel very strongly that the New York Stock Exchange should not overlook any opportunity to perfect its methods of operation, and where methods and principles superior to our own have been developed by other exchanges anywhere in the world, it behooves us seriously to consider the feasibility of introducing them in New York. The

United States has today become the greatest international creditor nation in the world, and it is obviously necessary for those of us who are engaged in the security business to have a wider understanding than ever before of many forms of foreign financial practice, and to overlook no opportunity which foreign experience may afford in rendering our financial machinery in all possible respects the most efficient, equitable and economically sound in the world.

VI

Reverting a moment to the question of speculation, it is a curious fact that this country which probably owes a deeper debt to speculators than any other country in the world, should be sometimes so emphatic in suggesting its abolition. If it had not been for the financial speculations of Queen Isabella of Spain—speculations the money for which was, according to the old story, obtained by pledging the royal jewels,—Christopher Columbus could not have obtained the ships in which he sailed to discover the new western world. It was likewise the financial speculations in the stocks of the Plymouth Bay Company and the London Company which provided the funds employed in establishing the original Colonial settlements in Massachusetts and Virginia. After our Revolutionary War, Alexander Hamilton would have been powerless to fund the national debt of this country and establish its finance on a sound basis, without the willingness of speculators to purchase the original 6% U. S. Government bonds, which were in the beginning highly speculative securities. The great railroad systems, by the establishment of which our great western areas were won and consolidated into our Union, could never have been built without the constant support of security speculators in railway stocks and bonds alike. The opening of our vast mining and petroleum fields, the spread of

utility enterprises all over this country, and the establishment of industrial plants which are today unequalled in the world, have all similarly depended—and particularly in their early and most difficult periods—upon the process of security speculation, and its steady and beneficial regulation on the leading stock exchanges of the country. Nor is there yet any sign that this process is nearing an end. The age of scientific invention is not concluded. It is today only on the threshold of its development. Already such momentous innovations as aerial transportation are awaiting the accession of capital and practical organization by business executives, to be placed at the wholesale service of our entire people. If capital in adequate amounts for these things is continually to be found, speculation in securities is not an accidental accompaniment, but an indispensable causal factor, of the process. The stock exchanges of the world, despite the age which many of them have already attained, have only begun to perform for the public the economic services which they are able to perform. Stimulated by the driving force of scientific discovery, but tempered by scientific research, steady public education and the time-tested regulations of the organized securities markets, speculation in securities will in the future, as in the past, prove a gigantic economic power in mankind's triumph over the world of nature, and the establishment of ever higher spiritual and material standards in the daily lives of everyone.

THE MYTH OF AMERICAN FINANCIAL IMPERIALISM

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THE MYTH OF AMERICAN FINANCIAL IMPERIALISM

It is an unusual privilege, and one which I deeply appreciate, to have the opportunity of addressing this distinguished audience. I may perhaps be forgiven for the feeling that occasions of this sort, where America's present position as an international creditor nation can be frankly and calmly discussed without the pressure of any particular situation or problem, constitute a happy augury of a closer future cooperation and mutual understanding in such matters by the State and American business. The United States, I feel, has entered a period in her history unique alike in its responsibilities and opportunities of betterment, and a harmony of thought and attitude between the State and its citizens toward our rapidly changing financial and economic problems is more than ever indispensable.

Many portions of our new national duties as the chief creditor nation of the world must be left, largely if not entirely, for private business to perform. But it is equally true that many of our new national functions in this regard can be and should be performed by the Federal authorities alone. It is for this very reason that I have no intention of including in my remarks tonight, any reference to the subject of the inter-allied governmental debts or their settlements. This great problem very properly pertains to the State, and the State alone. Upon it Congress has quite definitely taken its stand. In a republic like our own, this is the natural and regular channel through which public opinion should be mobilized and expressed upon public problems of this sort. Sometimes we business men complain

that the State is encroaching upon or interfering with private enterprise. We should ourselves be equally ready to avoid interfering with those questions which are clearly in the domain of Government. For my own part, I have no desire to offer unsought advice or venture suggestions as to the proper course for the Federal Government to take with such State problems as the inter-allied debts. I will therefore confine my remarks on the subject of American international lending tonight, entirely to those loans which have been made privately on the initiation of American bankers and financial institutions generally. As a matter of fact, this is a sufficiently extensive topic for one evening anyway.

Most of us, I imagine, will agree that the present economic and financial position of the United States internationally is quite unprecedented in our history. Indeed, it is doubtful whether any very close parallel to it could be found in the annals of any other country. To clearly state and gauge our present international position financially, it is necessary to consider the steps which have gradually led to it. I must therefore ask your forbearance if at the outset of my remarks, I outline a few of these steps quite briefly.

II

Ever since the American railroads forged their way over the Appalachian mountain chain, and provided ready passage for men and goods into our vast interior areas, the main effort of the American people in an economic way has naturally and inevitably been confined to the mighty task of conquering a continent. The opening up of our great central valley to settlement a hundred years ago diverted an earlier interest in the sea-ways and foreign trade, to almost purely internal and domestic affairs. The

magnitude of the task of colonization and settlement which our forefathers undertook a century ago should not be forgotten or minimized today. No country in history, with the possible exception of Russia, ever attempted to incorporate within its own political and economic boundaries a wild and trackless region of such vast distances and such geographical diversity. The unique character of the American westward settlement, indeed, becomes all the more marked when we realize the ultimate collapse of the parallel attempt of Russia to rule and develop her great Siberian provinces effectively and in a unified way.

It has, after all, been from our great and successful adventure in land colonization within our own borders, that not only our present national wealth but also the very spirit and temper of our people has developed. The American of a few generations back who ventured into the wilderness, had perforce to create and follow a novel set of standards and ideals for himself. It is undoubtedly true that in this process of adapting himself to his new wilderness home, the American pioneer was forced to slight and neglect some of the refinements and amenities of life by which older and more settled human communities set such store. By the nature of circumstances, he was compelled to give his whole attention to the task immediately before him. As he passed deeper and deeper into the heart of the great North American continent, struggling as he went against the wilderness and the blind forces of nature itself, much of the knowledge and understanding which he had had of the older world of Europe faded. News of the wars and truces of European kings and ministeries came to him only slowly, distorted by distance and tinged with an unreal and legendary character.

But, in return for this inevitable narrowing of the American pioneer's horizon, he developed other and compensating qualities. Thrown wholly on his own

resources in the savage wilderness which he had invaded, he came to appreciate without bewilderment or fear the hard facts of existence, to possess self-reliance and originality, to cherish personal independence, and to be animated by that passion for self-improvement which has rendered this country unique in the annals of history. This pioneer spirit, even though it has at length achieved the conquest of a continent, is still with us. It animates both American government and American business today. It justifies the feeling which we all so deeply possess, that no national problem in the future can prove so great that with sufficient thought and effort it can not be solved. It lends conviction to our hope that, if it is the destiny of this country to exercise the functions of the greatest financial power in the world, we can and will adapt ourselves to the performance of this new task.

Until roughly the beginning of the present century, our huge program of domestic and internal development had made this country the leading debtor nation of the world. The settling of our vast internal areas, the establishment of transportation lines and the extraction of raw materials here, called not only for the almost exclusive attention of our people, but also for much greater amounts of capital than we possessed. As a result, the investors of foreign countries came to purchase enormous aggregate amounts of American railway and industrial securities, and thus make available millions of dollars for the up-building of this country. A large portion, in fact, of the surplus wealth of Europe was over a long period of years steadily poured into the United States. The unprecedentedly swift development of this country during the past century would of course have been entirely impossible without these large amounts of foreign capital which were thus available for it through the security markets of the world.

By 1900, at the turn of the century, certain indications gave grounds for the belief that this status of America as a continual and enormous debtor nation internationally, might not indefinitely remain. In the first place, the British war in South Africa pre-empted surplus British funds, and thus for the time being prevented the normal flotation of foreign loans in London. In consequence, a few foreign securities for practically the first time appeared on the New York Stock Exchange, our people suddenly experienced a new interest in foreign countries and foreign affairs, and some financial observers became persuaded that America had at length become a creditor and international lending country.

In the second place, our own war with Spain resulted in our acquiring new colonial possessions in both the Atlantic and Pacific, and in both the northern and southern hemispheres. To some foreign critics, the United States appeared to be entering an imperialistic phase of development already made familiar by the great powers of Europe. It was freely predicted abroad that now the United States must be reckoned with in the almost universal competition of the powers to seize new territories. It was a period when blatant national jingoism was almost everywhere manifest, and when the encroachments by the great nations upon the weaker peoples of the world were defended on the score of "the white man's burden." Even in America, many thoughtful statesmen and citizens did not hesitate to express the fear that the United States also would yield to the omnipresent allurements of international aggrandizement, and come to participate in a colonial policy upon which the larger European countries had long been intent.

Subsequent events, however, sharply and definitely disproved such predictions. Our supposed financial creditor position internationally soon proved an illusion. The internal American demands for capital

continued to absorb not only all the savings of our people but foreign capital as well, and in the panic of 1907 our debtor position was clearly revealed. But even more fundamental was the overwhelming instinct which arose among the people of this country against harboring ambitious foreign policies and entering the international quest for new colonies. The descendants of three generations of American pioneers revolted at the thought of dissipating the fruits of our hard-won internal conquest over the American wilderness, in senseless and needless foreign adventures. The result was the evolution of a foreign policy new in the annals of the world—a policy of tutelage and protection for the weak until they could develop sufficient strength and stability to become truly independent, and be welcomed as equals and friends in the society of nations. Because it was new and untried, naturally such a policy has sometimes been difficult to maintain. It is easy—as uninformed foreign writers have frequently done—to condemn it as unworldly, or suspect it as hypocritical. That it has not been without some minor inconsistencies, no one will deny. Yet it is worlds away from the land-hunger so natural in heavily populated Europe—which was undoubtedly one important cause of the recent world war.

During our period of neutrality in the war, vast quantities of American securities held by the belligerent and previously creditor nations of Europe, were resold to American investors through the New York Stock Exchange and other American security markets, while at the same time and of course subsequently, large amounts of foreign securities came to be distributed among American investors. For the first time in its history the United States has found itself, not only an international creditor as respects the rest of the world, but in such an economic and financial condition that it can spare funds from its historic task of building up this country, to

loan to foreign governments and even foreign business corporations. Indeed, with the scarcity of funds abroad and their abundance here, it is inevitable that capital will like water tend to seek its own level. The result of such a tendency is for the steady export of American capital abroad.

The present financial position of this country also contrasts sharply with that of a quarter-century ago in the very important fact that we have today in our Federal Reserve banking system a tremendous source of economic strength and stability. When the perspective of time allows the real story of the recent war to be written, much stress will be laid on the—for us—almost providential fact that on the very eve of the great conflict, the United States for the first time in its history became possessed of a flexible yet powerful and centralized mechanism for the mobilization and use of its bank credit and currency. The really extraordinary story of America's own participation in the world war would have been a very different one, if the keen foresight, admirable thoroughness and genuine patriotism of our Government authorities had not brought into being this dependable bulwark of financial strength at the very time the need for it was greatest.

The situation of the United States today as the leading creditor nation of the world, with a powerfully organized central banking system, is so new and unfamiliar to Americans themselves that it is little wonder if its future possibilities have been and are misunderstood abroad. Neither is it surprising that our national financial and economic situation is misinterpreted in other countries as imperialistic, in the old pre-war meaning of that term. After all, Europe is today judging us in this respect by her own past history. Until we on our part consider what certain economic and nationalistic aspects of that history have been, we cannot ourselves altogether understand the basis of some of the ground-

less fears and serious misapprehensions of this country which seem to exist abroad today.

III

For almost one hundred years, there have been nations in the world that were able steadily to invest part of their surplus funds abroad. Thus, though this experience is novel to us, the basic economic principles by which it operates, are sufficiently established. In most cases, such nations tended to expand their export trade by the foreign loans which they absorbed, although frequently an even greater expansion was seen in their import trade. On the stock exchanges of such creditor countries, foreign securities invariably appeared, and international financing became there a regular part of the national business.

Great Britain was the leading pioneer in developing the functions of an international creditor nation—a natural result of her leadership in the industrial revolution which occurred at the beginning of the nineteenth century, and of her far-flung colonial empire, which proved so fertile a source of lucrative foreign investments. Yet British capital also flowed out from London to many countries which were not parts of the British Empire at all—notably, of course, to the United States itself. The flow of British capital abroad has sometimes been held to have been imperialistic, if not in its original intentions then in the actual results to which it led. On occasion the British navy and the British army came to follow paths into foreign countries which had been blazed for them by the pound sterling. Some historians, for example, cite the British investment in the gold and diamond fields of South Africa as a primary cause of the Boer War. On the other hand, the British Empire was a large affair before London could furnish any great amounts of capital for foreign invest-

ment. Moreover, it can hardly be claimed that the United States ever experienced the effects of a British financial imperialistic policy, although in some of our railroad receiverships a generation or more ago many British investors were sometimes rather harshly and severely handled. As a matter of fact, no country's foreign policies in regard to its foreign investments have been strictly consistent, and without the exceptions and paradoxes so often imposed by changing ministries and shifting tides of public opinion. Yet the fact remains that the growth of the British Empire cannot be altogether disassociated from the masses of foreign securities which were absorbed by British investors through the vast London financial market.

With Great Britain, however, capital flowed out to other countries through a free and open securities market of world-wide scope, and direction was given to it primarily from economic rather than political motives. In the main, British foreign investments had in consequence a pacific effect. But other nations, slower to acquire foreign colonies and possessions than Britain, were more inclined to give direction to their foreign investments principally and sometimes primarily on a basis of political considerations. It became, in fact, a recognized practice in international affairs and relationships, to employ foreign investments as a pawn in the attempt to expand territorial possessions. With certain Continental countries, the statesman and sometimes even the military strategist stood almost constantly behind the security investor and the investment banker. Such a direct union between what was known as "high finance" and "high politics", while essentially an effect rather than a cause, nevertheless led by successive steps to the World War.

Today, these things are remembered—sometimes with great bitterness—in Europe. But the effect of the war there has been to curb if not utterly to halt

the flow of European capital to other countries. Whether or not foreign investments are inclined to produce of their own accord a policy of financial imperialism in the lending country, so few European countries today are in a position to make any continuous foreign loans that they can scarcely be attacked, except in exceptional instances, on this score. On the other hand, the European sees the United States as a new and to him unfamiliar world-power, possessed of what seems to him enormous wealth, and apparently already engaged in much foreign lending. It is only human nature to fear what is not understood, and to judge a new situation by standards inherited from a familiar past. No wonder, then, that Europeans declare that the United States has undoubtedly adopted a policy of financial overlordship and imperialism to the present-day debtor countries of the world.

The European attitude has been very aptly expressed, it seems to me, by an eminent European economist, wise enough to understand fallacious ideas with which he does not sympathize himself. As he recently stated the matter:

“The nations of Europe have never shared America’s simple optimistic belief. Their history has taught them skepticism. Never before have they seen the rise of power in the world without being conscious that it is sure to be misused. For the chief object of power, as they see it, is not merely to gain security for yourself, but to use it as a weapon to enslave others. Europe is not willing to make the United States an exception to this rule.”

Curiously enough, according to this experienced author, America’s very efforts to promote disarmament among the nations are so novel and strange as to increase rather than diminish Europe’s apprehension concerning us.

"It seems to these observers," he continues, "as if there were some hidden scheme somewhere, as if there were some minds in the United States planning a huge system of international economic peonage, a system whereby the debtor country is hopelessly dependent upon the creditor. There is an uneasy feeling in Europe that the United States is aiming to grasp the lordship of the world by trying to cripple other nations. Debtors are more grateful toward their creditors when the shoe pinches."

To the inhabitants of nominally debtor countries, mainly in South America but to some extent, no doubt, in Asia also, the charge of "financial imperialism" raised against this country abroad falls on receptive ears. This attitude should be all the easier for the United States to understand, since for so many years we ourselves were the greatest debtor nation in the world. It seems something beyond human nature for a debtor to love his creditors. Despite the enormous assistance which British capital lent to the building up of this country during the nineteenth century, much angry talk of "British gold" was occasioned by it here. Now that we have become the great lending nation of the world, the shoe is on the other foot, and it is "American gold" concerning which so many indignant protests and sinister allegations are being made in other countries.

Popular cartoonists, who so frequently are an accurate index to popular thought, have seized upon the undoubted wealth and the frequently misunderstood aims and ideals of Uncle Sam, and pictured him as a long-legged giant, laden with money-bags and decorated with dollar signs, bestriding the world. At a time when American capital invested in foreign securities has proved the chief stabilizing factor in a disorganized world, the United States is depicted as a bullying and greedy plutocrat, bent only on the

oppression and subjugation of other nations. It were well for us to consider impartially and carefully the foundations for such an attitude of mind toward us 'abroad, and particularly to analyze this new "financial imperialism" of which we are being so frequently accused.

IV

The first economic aspect of the United States today upon which I would comment is our comparative independence of the rest of the world in respect to raw materials. Almost all the latter which are needed in our industries can be and usually are being produced within our own boundaries. If a tremendous hostile fleet should completely blockade our coasts and prevent any incoming cargoes, it might compel a considerable change in our methods and habits of living, but it would not succeed in prostrating our industries or starving our population. Indeed, such is the production of raw and finished goods in this country today that it would be superabundance rather than famine which would constitute our greatest problem. Especially there is absent here that critical inability to feed ourselves which is the nightmare of many older and more heavily populated countries. The pressure of our population on our agricultural and other resources has not yet begun to attain any such condition as this, nor does it promise to do so for many years.

In consequence, there is no such land-hunger with us as has at times existed in other leading countries of the world. I am not imputing to ourselves any higher morality or scrupulousness than that possessed by other peoples. Entirely apart from this phase of the question, there is no valid reason why, with our vast and undeveloped land resources in the United States, we should desire or grasp for new lands and territories. The basic colonial policy of this country has therefore been unique in history.

We have endeavored to develop our colonies for a stable, peaceful and independent existence, and grant them freedom as soon as circumstances permit. While foreign orators and journalists are accusing us of encroachments and aggrandizements, the United States has been foremost among the nations of the world in furthering by practical and unselfish methods, an ordered and peaceful independence among the lesser countries. When the enormous coast-lines, the vast area, the abundant wealth and the heavy population of this country are taken into consideration, the armaments of this country are small beside those of other countries.

Such being in brief the actual political and economic situation of this much-feared "Colossus of the West," let us for a moment look at the problem from the financial aspect. I have pointed out that in the old pre-war days of "balance of power" in Europe, there was very frequently a close and intimate connection between the governmental policy of a lending nation and its foreign loan machinery. Popular foreign cartoonists, by depicting Uncle Sam ensnaring the world with his insidious money loans, convey the idea that it is the United States government that, for its own purposes, is extending these loans to the debtor countries.

However convincing such an idea may prove abroad, a candid examination of the facts at once shows what unfounded and dangerous nonsense this really is. There is an almost complete disassociation between the United States government and the American financial markets. With genuine sagacity and foresight, the national government has always refused to become entangled in our private financial affairs, or become itself responsible for them, by attempting any such policy of governmental control over our financial institutions as was basic in the pre-war European conception of the Imperialistic State. Our financial business and our financial in-

stitutions have to the fullest possible extent been left almost entirely free from governmental interference to pursue their affairs according to economic considerations. Loans are not being extended to foreign countries at the suggestion or initiative of the State, but by private firms and private investors on their own initiative and according to investment factors.

What supervision the Government has actually extended over foreign loan flotations in this country has been purely negative in character—that is to say, the Government has provided a brake rather than a motor for the process of American foreign investment by opposing certain loans on certain occasions, but never urging positively that loans be made. This type of supervision is a necessary and indeed inevitable operation of government. If foreign loans are being made of a character to embarrass or compromise the government in its own debt-settlements with foreign states, or if American funds are going abroad to build up foreign monopolies or other factors injurious to American commerce or internal trade conditions, inevitably any government would take an interest in the matter. It goes without saying that this governmental attitude toward foreign loan flotations in this country is a delicate matter. Europeans, more accustomed than ourselves to an over-paternalistic control by the State of the foreign flow of domestic capital, can therefore readily imagine our Government's becoming elaborately and undesirably involved in American foreign lending, and indeed directing such operations for its own ends and purposes. To any American who can pretend to be familiar either with our Government or with our financial markets, such ideas as these are of course ridiculously fantastic. All the elements of our intelligent economic self-interest, all the traditions of our Government, all the temper and spirit of our people would oppose any such course here.

Misapprehension concerning the likelihood that this country will ever make a political tool of its capital markets to further a policy of foreign aggrandizement can arise only from an utter ignorance of American government and American business alike.

Apart from the governmental aspect of the question, what is this "financial imperialism" of which we are hearing so much nowadays? Stripped of rhetorical and imaginative phrases, it comes down to the proposition that we have a certain amount of surplus funds which other peoples are anxious to borrow. The extent of our supposed "overlordship of the world" consists simply in our request that, once contracted, these debts to the American investor will be honored and paid, and that the funds which they represent will be used for peaceful and soundly productive purposes. In the long run, of course, such requirements placed by intelligent American bankers and investors on foreign loan securities which they are willing to buy are to the best advantage and benefit of debtor as well as creditor. As far as our ability to understand and sympathize with the feelings of debtor countries is concerned, it should be remembered that in its time—and it endured for several generations, too—this country itself was the greatest debtor nation in the world. As far as any desire on our part to reduce anyone else to a state of economic peonage, it should be remembered that the large capital enterprises of this country were the first to discover the economic fact that impoverished customers and large-scale profitable production do not go together.

As far as foreign security loans in this country are concerned, it is very necessary to rid ourselves of sentimental ideas in handling them, and to judge them realistically and impersonally from the business viewpoint. Such a policy sometimes is unpopular with the borrower. No less does it impose obligations on the lender. The American business man

and the American investor have the same tendency to self-complacency and sentimentality as other peoples elsewhere in the world.' Sometimes we like to think of ourselves as a sort of patronizing Lady Bountiful, patting all the good little European nations on the head and giving them sugar-sticks, and it is a great shock to us when the recipients of our supposed generosity seem somewhat irritated and unappreciative of this attitude on our part. If American finance is to play its part in world reconstruction sanely and efficiently, we must consider our foreign investments as a business proposition. The American investor, after all, has little reason to consider himself a philanthropist because he buys a foreign bond; neither is he a bully, or a conspirator for the "overlordship of the world," if he expects to receive interest and repayment promptly when due.

There is a final phase of this question of America's supposed financial imperialism upon which I would briefly comment. Today the world has, it seems to me, a very compelling and convincing object lesson in the actual value of that type of financial imperialism which existed before the war. We have seen Germany, where once the banker was forced to shape his operations according to the demands of the field marshal, divested of her colonies and her fleet, and now, under freedom from such a policy, laying the safe foundations for a peaceful and lasting prosperity. We have seen Britain, which has poured forth her treasure so unstintingly to upbuild her over-seas dominions, suddenly confer upon these dominions not only self-government but a status of equality with the home country itself in the new British Commonwealth of Nations. After all, these and other similar striking developments in the modern world are ample evidence that the diversion of national finances to promote national aggrandizement and the acquisition of new territories abroad, is a policy

which in the end defeats its own purpose and topples over by virtue of its own weight. Far from the likelihood that the United States will in future years attempt to model its actions on such obsolete methods of finance, what is really happening is that the financial policies and practices of foreign governments in this regard are today pursuing a course which in large measure the United States has initiated and followed for many years. Not only would a national imperialistic policy in finance be repugnant to the great rank and file of this country, but it would be sharply and vigorously attacked in the very financial centers here where such plans are sometimes supposed to originate.

Yet unsound fallacies and exploded ideas, in international no less than in domestic affairs, sometimes die hard and slowly. However unfounded in fact, however contrary even to our own intelligent self-interest, the American government and American finance will both no doubt continue to be attacked from time to time as imperialistic. In some foreign borrowing countries, refusal to grant loans is taken as an affront, while loans actually granted will in some quarters be interpreted as another attempt of the imaginary Uncle Sam of the foreign cartoons to enchain and enslave the debtor. Some day, perhaps, we may succeed in getting rid of the peculiar mythology which has long existed in almost all countries concerning financial centers and financial operations. In the meanwhile, it remains for our government and our financial community alike to see to it that our new facility for extending American funds to foreign states and foreign enterprises is not abused or made to serve any of these fantastic purposes which irresponsible sowers and spreaders of international hatreds and dissensions overseas, are so quick to attribute to us. A kindred duty likewise rests upon our financial institutions to afford the utmost possible protection for American in-

vestors in this new class of investments. As a matter of fact, far from our being inclined to scrutinize the foreign loans which are being made here today with too cunning and calculating an eye, the real tendency has been for us to subject them to insufficient scrutiny from the investment standpoint. For this new species of financial effort, we must develop new standards of value, new repositories of information, and to some extent a new financial technique. Indeed, great strides in this direction have already been taken, but much still remains to be done.

Reverting again to the economic aspect of America's recent foreign loan flotations, no one for a moment defends the artificial pumping of American dollars into foreign countries or foreign enterprises which do not really need them, or which will not presumably employ them in a sound way. Such a process of over-lending abroad has actually occurred on certain occasions with other creditor nations, and the United States as a new creditor nation must particularly beware of any such tendency recurring here. For unsound foreign security flotations not only impose losses on the investor, they encourage and perhaps temporarily subsidize unsound government finance and unsound business administration abroad.

On the other hand, the judicious investment of our dollars in foreign securities has ever since the Armistice held forth to the world a powerful assurance of a reconstitution of public order and safety, a reconstruction of industrial and agricultural prosperity, and a return to the peaceful and creative habits of life which were halted by the Great War. It has been very largely due to the flow of American capital overseas that the war-shattered railways, utilities and factories of Europe have been rebuilt, that the tottering financial institutions have been repaired, and in some cases that the public credit of entire

nations itself has been restored to health and vigor. Like the waters of another Nile, the flood of American funds has gone out to fertilize the scorched and barren waste places of the world, to explore and subdue the savage wilderness, and to lay the firm foundations for a period of international peace and prosperity in whose benefits both debtor and creditor countries will amply share. This is a great work—in the modern world of affairs it is doubtful if there is any more necessary and more full of promise for the future. America, having attained an economic maturity, having become the greatest international creditor nation of the modern world, is facing an almost limitless panorama of opportunity for bettering both itself and the world. It remains for us to see that this opportunity is not squandered, that our new financial facilities are not misused through our pride or blunted through our self-satisfaction, and that during the period of American financial pre-eminence every effort shall be made so to direct the flow of American capital here and abroad, as to realize actually and definitely for the average man a betterment in his way of life, and a greater hope and enhanced promise for those who shall come after him.

THE STOCK EXCHANGE
AS A STABILIZING FACTOR
IN AMERICAN BUSINESS

*Address before the Advertising Council of
Chicago, at the Hotel La Salle,
February 25, 1926*

THE STOCK EXCHANGE AS A STABILIZING FACTOR IN AMERICAN BUSINESS

The United States today is enjoying a widespread and in many respects an unprecedented prosperity. Few indeed are the lines of business which have not shared in it. Although we have in this country experienced similar waves of prosperity many times in the past, few if any of them have the enduring and basic appearance possessed by the present one.

It is not, however, my purpose here today to endeavor to compete with the daily press in presenting to you the obvious evidences of business prosperity which now surround us. It is rather to consider, in part at least, certain portions of our national business machinery which not only facilitate the coming of such periods of prosperity, but also the maintenance of prosperous conditions as long as possible by restraining the over optimism which they so often engender.

This is a day of specialization in business, with its resulting limitation in our general knowledge and understanding of the highly complex business structure and methods of the present. Most American business men are in fact somewhat like the passengers on a modern ocean liner. We witness the great speed at which we are travelling, we discuss the captain's schedule and the ship's course, and we enjoy the luxury of the ocean passage. Each of us knows something about what makes the ship go, yet probably none of us has a really complete knowledge of the machinery in its depths, of its methods of getting up steam, of the turbines which drive its mighty wheels and of the thousand and one lesser yet vital details of its tremendously complex mechanism.

I am not today going to attempt to take apart and

analyze all the machinery of the ship of American business. Indeed, like most of the rest of you no doubt, I frankly confess that much of this machinery I do not pretend to understand. It is only concerning a device on the engines called the Stock Exchange that I will venture to speak. Perhaps there are business men who already would be prepared to quarrel with me over my choice of metaphors, and to declare that the Stock Exchange should not be assigned to the engine room—that it really belongs with the bridge tables and shuffle boards on the upper decks. Actually, however, the securities market on the New York Stock Exchange plays a most important part in the daily work of keeping American business on an even keel and holding it continually to its course. For the organized securities market on the Exchange serves in most important ways to stabilize not only financial but also industrial and commercial conditions throughout this nation.

II.

When we speak of the New York Stock Exchange as a stabilizing factor in American business, it is necessary to consider not only what the Exchange really is, but also in what business stability really consists. Just now the plea to “stabilize business” is heard on every side but all too few of its advocates ever stop to define very exactly what they mean by “stabilization.” Some apparently think that stability in prices consists in continually raising them. Most men, in fact, are human enough to show the maximum enthusiasm over programs for stabilizing business under which they themselves will be likely to profit the most in immediate dollars and cents. On the other hand, it should be obvious that if business stability is to be narrowly defined as a complete lack of change, and an endless perpetuation of existing business conditions, all progress and invention must be ruled out as factors in our future

economic well-being. It is therefore apparent that the real virtue of stabilizing any given situation in business depends very largely on circumstances, and should not be entered into without due consideration and analysis. When carried to artificial and extreme lengths, programs for stabilizing business invariably run up against economic laws which in the long run prove insuperable. A century ago a noted philosopher exclaimed "Liberty! What crimes are committed in thy name!" The modern day philosopher might be justified in making the same remark about "stabilization," if some of the pseudo-stabilizing schemes so insistently urged for almost all departments of business, were actually and suddenly put into effect.

Despite all the attempted misuses of plans for stabilizing business, however, everyone recognizes that needless, irrational and unjustified changes in business conditions are almost universally harmful and deplorable. As a matter of fact, the effort to stabilize business is profoundly and vitally presupposed by the very processes of all civilization. On its material side, indeed, civilization might be defined as a process of eliminating or at least minimizing the risks and dangers of daily life. Slowly yet none the less steadily, civilization has lessened the individual's daily risk of physical violence. It has none the less strikingly worked to reduce the risks of sickness and disease. It is little wonder, therefore, that in the sphere of business no less than in the political and medical aspects of life, civilization is more and more incessantly demanding a similar cessation of the preventable risks attendant upon the individual in his economic life.

While undoubtedly the great popularity of the slogan "Stabilize business" is comparatively recent, the roots of the movement extend far back into history. Consciously or unconsciously, the desire for more dependable and steady economic conditions

has prompted progressive legislation, and stimulated the development of sound business methods, for many centuries. But it has only been in the last half-century, when the overwhelming risks of war and disease have come to yield step by step to the onward march of civilization, that mankind has been able to spare time from its preoccupation with the struggle for existence to think about the struggle for a standard of living.

It is in his economic capacity that man provides himself with food, clothing, shelter and amusement. In proportion as the risks of war and disease are mitigated by the progress of civilization, the risks attendant upon his economic life become more and more a claim to his attention and his constructive efforts. It is thus quite probable that the present movement to stabilize business and economic affairs will prove one of the greatest problems of the present century. Genuine achievement in the way of reducing the needless risks of business is, therefore, something more than the neat solution of a merely abstract economic problem. It is an indispensable contribution to the better and fuller flowering of civilization, in even its highest and most spiritual aspects. It makes directly for the more intense and satisfying enjoyment of life, liberty and the pursuit of happiness by all the race.

In its risky and uncertain youth, America had more excuse for constant tumult and fickleness in its business affairs than it has today, when the United States has so obviously attained the fuller powers of economic maturity. Many of us here tonight can recall quite clearly the great business crises which occurred in this country in 1907, in 1914, and again in 1920—all within the last twenty years. Certainly none of us would choose to conduct his business through another crisis of the same kind if he could help it. It is a practically universal feeling on the part of American business men that prompts the common

present-day question, "Can catastrophes in trade be actually prevented in the future by stabilizing business,—and if so, how?"

Certainly in the vigorous cooperative effort which American business has made since the panic of 1907 to prevent another such occurrence in the future, one of the most important and most constructive accomplishments has been a thorough overhauling of the machinery of American business, and the development of new business institutions and new business practices capable of relieving and mitigating undue and dangerous economic conditions of strain in the future. Although human nature changes very little, nevertheless to a considerable extent the business men of this country have themselves grown wiser, and more anxious to exercise in their own operations an intelligent foresight and an enlightened self-restraint. But what is probably still more important—we have in the past twenty years very greatly improved the ordinary methods by which business is carried on in this country, and very considerably expanded and improved those credit institutions upon which the brunt of a business crisis so heavily and invariably falls.

The most conspicuous example along just this line has undoubtedly been the development of our splendidly staunch and flexible Federal Reserve banking system. In 1920 the business horizon was once again darkened with thunder-clouds, but the storm did not fall—as previously it had in 1907—upon thousands of completely separate and isolated banking institutions without a common leadership, a united purpose, or the tremendous strength which comes from nation-wide cooperation. Instead—and for the first time in the history of American finance—the after-war collapse in 1920 was met resolutely, unitedly and intelligently by our American banks under the leadership of the Federal Reserve system. If today—only six years afterwards—the United

States finds itself enjoying an unparalleled prosperity from coast to coast, it is well for us all to remember the efficient and courageous work that the Federal Reserve system performed in the very gloomy years of 1920 and 1921, when pessimistic prophets were not backward in assuring us that America's brief heyday of war prosperity was the last that this generation might see. In these days of our prosperity it is only just and fitting to recall the institutions which, in that time of severe depression, came most powerfully and effectively to the assistance of American business.

Although the fact is not so often recognized, the New York Stock Exchange belongs to this same group of institutions which are particularly useful to the entire American business community during periods of pressure and strain. Based on its own past record, I have no hesitation in saying that should American business be seriously menaced in the future, the Stock Exchange will be found fighting shoulder to shoulder with the Federal Reserve system and other constructive institutions of the land to restore, preserve, and to sustain business prosperity. The New York Stock Exchange was not, of course, created in the last twenty years—it was founded over a century ago. Yet within the past twenty years the Stock Exchange has experienced an expansion in its machinery and a perfection in its technique that have been truly remarkable, and that have rendered it the thoroughly national and democratic financial institution which it is today. But it has not been my purpose to come here tonight so much to praise the Stock Exchange and its operations, as to explain them. Accordingly, I wish to call to your attention some of the principal ways in which the Stock Exchange today serves to render all American business a more constant and stable proposition.

III.

One of the greatest services in behalf of business stability which the New York Stock Exchange performs, lies in the important part it plays in directing investment capital into the particular lines of business where it is needed and can be profitably employed, and diverting it from other business activities where additional capital is neither required nor justified. Economists tell us that business depressions are to a large degree due to a disproportion and maladjustment of capital between the many departments of modern business. Today there are over 1,000 separate stock issues and nearly 1,400 separate corporation bond issues listed on the New York Stock Exchange. Thus a vast panorama of American and even foreign commercial and industrial enterprise is set before the countless thousands of modern investors, with current quotations available on the tape or in the newspapers. More and more the stock market tends to rise and fall by groups of securities rather than as a whole. In a given year, steel securities—let us say—may be dull, while railway securities experience an active and rising market. In a general way, such a development would indicate that more investment capital is needed in railroading but not—for the time being at least—in the steel industry. During every so-called “boom” in the stock market, certain groups of securities will lag behind, while during every stock-market depression certain groups will decline very little. It is the Stock Exchange which brings out these inevitable economic tendencies into the light, which makes them evident to the man in the street, and thereby provides the machinery for a swift and intelligent mobilization of public opinion in regard to the proper direction of the nation’s investable funds. The consequence of this perfectly normal and therefore frequently overlooked process is, that American industry more and more is able to avoid

a glut of capital in one place and a famine of capital in another. The steady and accurate guidance of investment funds into the different departments of American business is a major stabilizing force in prosperity, and the New York Stock Exchange proves each year a principal factor in facilitating it.

But stabilization, as I have already pointed out, should by no means involve inflexible and unchangeable prices. It is because prices on the Stock Exchange are ever changing, that the Exchange is able to increase the efficiency with which the savings of our people are employed in industry. Any artificial and uneconomic stabilization of Stock Exchange prices would consequently vitiate one of its most important services in the larger stabilization of all American commerce and industry.

A second important contribution to the cause of business stability made by the Stock Exchange is the steadily increasing public knowledge regarding corporate affairs which it facilitates. For many years the Exchange has led the fight for wider and more complete corporate publicity. Recently the listing requirements of the Stock Exchange have been again expanded and particularized, to embrace foreign government bonds as well as domestic and foreign corporations. One does not realize how far we have all progressed in the dissemination of current and accurate information regarding our leading business companies, until he examines the business information available to the average investor 50 or 60 years ago. The old prospectuses of railroad securities back in that period are very illuminating and curious to us now. The investor used to be told how large the new issue was to be, now many miles of track the company operated, and a few other scattered and inconclusive scraps of information. There were no balance sheets and income statements regularly published. There was no regular and dependable information regarding dividends. Any-

one who purchased securities on this basis—even when the securities represented the largest and most substantial business companies in this country—had to depend on gossip and blind faith rather than upon analysis or sober business judgment.

But we have not yet by any means reached the end of this constantly growing demand for wider corporate publicity, and the Stock Exchange is still doing all it can to further and assist the movement. There can be little stability in general business without stability of investment conditions, and stable investment is completely dependent upon knowledge and upon facts. An important element in the depressions which we are all desirous of minimizing or avoiding in the future, is the tendency of business in prosperous periods to build up large capital structures out of proportion to future earning power. It is questionable whether public law or private example can ever wholly eliminate this perennial enemy of stable business. But it can be checked and—compared at least with former periods—it is being checked by the more complete and accurate information regarding business companies for which the New York Stock Exchange has so long striven.

Perhaps the most serious menace to stability in the American investment markets is the very old and very widespread problem of fraudulent securities. I do not hesitate to assert that the enormous sums which inexperienced American investors are each year persuaded to pour into worthless and crooked business enterprises is not only a serious drain upon the resources of American business but also a prime factor in hampering and limiting the proper stabilization of our national business conditions. In recent years the New York Stock Exchange has made a persistent and strenuous attempt to warn the investors of this country against security swindlers, and by close cooperation with government and

private fraud-fighting bodies and institutions, to render the prosecution of security frauds more certain, more severe and more effective. Not until this most important task of fighting the security swindler and all his works is actively taken up by business men all over this country, can this constant and serious danger to stable business in this country be effectively eliminated.

Probably the most obvious service performed by the Stock Exchange in the interest of business stability consists in the high degree of ready market-ability which it lends to the enormous aggregate amount of securities listed upon it. The market value of securities listed on the New York Stock Exchange at the present time totals nearly seventy billions of dollars—a sum approximately a quarter to a fifth of our total national wealth. On the whole, the New York Stock Exchange has been remarkably successful for over a century in this work of maintaining a reliable open market for the leading American securities. In connection with stabilizing business, this main function of the Stock Exchange—to render its listed securities always salable and purchasable—is exceedingly important. In the past, the panics in this country have not been due so much to any actual poverty or lack of property, as to a sudden illiquidity or unsalability of property. Due mainly to the New York Stock Exchange, stocks and bonds have proved the most readily salable commodity that we have. Time and again when raw materials, real estate and even staple merchandise have suddenly proven unsalable, business men have been able to tide themselves over with cash derived from the sale of their securities on the Stock Exchange. It is especially important from the standpoint of national business to have a market of this sort where securities can be speedily sold. For securities, as far as their holder is concerned, represent a surplus, and in consequence the New York

Stock Exchange represents a market for the national surplus of wealth. Like all other surpluses, it grows in times of prosperity and is drawn upon in days of adversity. In fact, the same economic forces which cause the upward and downward movements in our individual surplus wealth are responsible for the major upward and downward movements in security prices on the Stock Exchange. It is of course desirable that these alternations between increasing and decreasing our surplus should be attended with as little violence or strain as possible—or, to put the matter in a slightly different way, that the movement of the Stock Exchange security prices should be stabilized. But we must realize at the outset that any program for such an extreme stabilization of security prices as would prevent the full usefulness of our surplus, would be a delusion in the first instance and tremendously harmful to all business in the second. As a prominent financier of the preceding generation used to point out, the only reason for maintaining a surplus is to use it. If American business in times of adversity expects to gain stability for itself by dumping its surplus security investments on the Stock Exchange markets, it must not complain if the prices in these markets experience a considerable fluctuation as a result.

It is important to note that the Stock Exchange performs the same stabilizing services in this regard for banks that it does for individual investors. The banks of this country hold very large amounts of government and corporate bonds, and these are mainly liquid assets because so many of them can be instantly sold upon the Stock Exchange. Just as the stability of general business is largely dependent upon the liquidity of our banking system, so the latter is in turn due to an important degree to the smooth and efficient operation of the securities market. But the Stock Exchange market is essentially democratic. It is open to all investors, large or

small, on precisely the same terms. A considerable drop in security prices on the Exchange thus arrays almost automatically the buying power of investors all over the United States behind our listed issues. The work which the Stock Exchange has done in thus arraying and mobilizing the buying power of the American investing public, is consequently a major contribution to the cause of general business stability.

IV.

An equally important service to American banking, and through American banking to American business generally, is the call loan market on security collateral whose present-day development has been possible only through the existence of the New York Stock Exchange. At this point it is timely to mention security collateral loans, because of the recent step taken by the Federal Reserve Bank of New York and the New York Stock Exchange, to cooperate in making public the approximate amount of outstanding brokerage loans. The work of distributing securities performed by members of the Stock Exchange requires the use of bank credit in much the same way that the distribution of any other kind of property does. Members of the Exchange obtain credit through what are known as time and call loans. The time loan, as its name implies, is made for 30 days, 60 days or some other fixed period of time, and at a fixed rate of interest. Call or demand loans, however, are made for the day only, and their rate may be, and often is, readjusted each day. The broker who obtains a time or call loan delivers to the lender security collateral whose market value exceeds the face of the loan by 20 to 35%. The lender can also require the borrower to substitute more for less desirable securities in the collateral, or to increase the total amount of collateral securing the loan. Since in

New York the bulk of security collateral on which money is borrowed represents issues listed on the New York Stock Exchange, it is at practically all times perfectly liquid and salable, and the lender has the privilege of selling it in case the borrower does not speedily furnish more or better security collateral on demand to protect the loan. It is a fair statement that no safer investment for banks exists than these security collateral loans, and that losses entailed by them have long been inconsiderable compared with practically any other form of short-term American banking investment. Due to their safety, these loans have enjoyed a natural and a steadily increasing popularity among American banks all over the United States for many years. Moreover, the banking funds thus liberated through the stock market have enabled the swift and constant financing of corporate business enterprise in America. One highly important factor in the amazing rise of American commerce and industry during the past 25 or 30 years, has been the ready funds available for issuing and distributing new security issues in Wall Street.

Before the advent of the Federal Reserve system, the call loan market afforded practically the only liquid and centralizing factor in the American money market. When depressions came on, American banks stabilized their positions to a large extent by calling their loans in Wall Street. In this way the burden of stabilizing American banking, and American business generally, was in the last analysis thrust upon the New York Stock Exchange security market. The system was far from ideal in and of itself, yet for many years the call loan market constituted the greatest single stabilizing factor that there was in the American money market. The establishment of the Federal Reserve system has, of course, taken much of this undue burden off the Stock Exchange market, by providing rediscount

facilities for American banks where commercial papers, bills and other commercial short-term banking investments can be exchanged for cash. Nevertheless, as I will presently point out, even after the development of the Federal Reserve system, the call loan market has proved a most valuable and important factor of stability, particularly in times of pressure and strain. One of the great advantages of call loans on security collateral has regularly been that the collateral represented is what I have called a surplus commodity. Thus, as I have already remarked, security collateral loans have been a sort of national surplus which could be drawn upon very effectively and beneficially. Under prosperity call loans have usually increased, yet their deflation at the first indications of commercial or industrial depression has regularly lightened the check of deflation to business itself. In consequence, the alternate rise and fall of security collateral loans has regularly proved a natural balance wheel to American banking and American business.

The security collateral call loan market has had and still has many critics. Undoubtedly certain of its aspects—as, for example, its ever-changing interest rates—are a proper subject for constructive criticism and suggestions. Yet it will not do for us to overlook the great compensating services which the call loan market has long rendered to American business and finance, or to apply to the call loan market canons of criticism which are not applied to other forms of banking investments also. Some critics of our call loan system have, for example, made the accusation that these loans are not really demand loans, since they could not all be called at once. While undoubtedly catastrophe would follow any attempt to liquidate all the call loan market at one time, we must be careful in such matters not to counsel perfection simply to the call loan market. If every depositor in an American bank should call

at once for the payment of his deposits in gold, we all realize that catastrophe would also follow. Yet nobody thinks of using this entirely theoretical case as a criticism of modern deposit banking. The call loan market, if it is to progress, of course needs keen and unsparing criticism. But it is entirely too important a factor in our financial organization today to remain a matter of public misunderstanding or a subject for any but the most thorough-going and impartial criticism and analysis.

V.

Hitherto the total amount of money involved in security collateral loans—and especially that part devoted to brokerage loans—has been a subject of conjecture rather than definite knowledge. Owing to the fact that the nation's leading security market is located in New York, a considerable proportion of loans on security collateral are made there, and the collateral is held there. Nevertheless the time and call loan markets are national in their scope. The thousands of interior banks send a large aggregate amount of money to New York to be loaned on security collateral, while the loans made in New York are contracted in behalf of institutions and individuals located all over the United States.

During the recent war, the tremendous and delicate task of floating our gigantic Liberty Loans made it necessary to ascertain the outstanding amounts of these obligations in the New York financial center, and for the first time in the annals of American finance this was done through the ready cooperation of the New York Stock Exchange and the Loan Committee of the New York banks headed by the Reserve Bank of New York. The latter institution gathered figures regarding the total loans made by its member banks to brokers, while on the borrowing side the New York Stock

Exchange collected a similar total of the outstanding loans of its member-brokers' firms. At that time it was obviously undesirable to make such figures public, owing to the existence of war conditions throughout finance, and the still impending government loans of enormous and unprecedented size. As in the case of so many other business innovations due essentially to the existing national policies of war control, this practice of collecting aggregate figures on brokers' loans was subsequently abandoned some years after the Armistice, when normal economic conditions of peace returned. Recently, however, both the Federal Reserve officials and the New York Stock Exchange have come to realize that much of the confusion of thought which apparently exists regarding brokers' loans has been due to the lack of definite and authoritative current figures of their amounts. This winter, therefore, the Reserve System and the Stock Exchange, again working in close cooperation, resolved to remedy this situation as far as possible by collecting and for the first time making public the total figures as to brokers' loans collected both from lenders and borrowers in New York.

The resulting figures, which have since appeared in the press, have very naturally revealed the fact realized by many of us all along, that the separate compilations as to brokers' loans made by the Federal Reserve Bank of New York and by the New York Stock Exchange are gathered on a different basis, and therefore very naturally do not coincide. For the member banks of the Federal Reserve Bank of New York make loans to security brokers and dealers other than members of the New York Stock Exchange, while New York Stock Exchange members obtain loans from sources other than the member banks of the Federal Reserve of New York. Nevertheless, indications are not lacking that the regular publication of these two separate

compilations as to brokers' loans will in the future provide a fairly adequate indication, not only as to the actual total of such loans outstanding, but also the useful economic functions of such loans as a stabilizing factor in American finance and industry.

VI.

There is a final aspect of the services which the Stock Exchange regularly performs in stabilizing American business conditions, that I must mention before concluding my remarks. Until approximately 1915 or 1916, the United States was a debtor nation internationally. We regularly imported capital from abroad, and in consequence many of the security transactions involved by the tremendous upbuilding of American industry occurred not on the New York Stock Exchange, but on the stock exchanges of foreign creditor nations. England, France, Holland and Germany—for example—invested tremendous total sums of money in American industry, and thus it followed that many American securities were actually traded in and largely carried by the stock exchanges of London, Paris, Amsterdam and Berlin and other such European credit centres. The day was, in fact, when every Wall Street man was practically compelled by circumstances to study carefully the transactions in American securities occurring in the London market, before he felt content to deal in the same securities on the New York Stock Exchange each day.

One effect of the recent war has been to reverse completely this situation. Today the United States is the greatest creditor nation in the world. Not only must all American financing be carried on today in security markets within our own borders—and of course to a large extent on the New York Stock Exchange as the leading American security market—but also much European financing on behalf of the

now debtor nations of Europe must similarly be carried on here. The economic consequences of this momentous change in the international status of the United States from a debtor to a creditor nation, is not yet adequately realized even by leading American business men. It has, however, affected the stabilizing functions of the New York Stock Exchange market in three fundamental ways.

In the first place, it seems unlikely that in the future this country will suffer from the intense shortages of money and credit which we so often experienced in the past. It is therefore probable that the Stock Exchange will in the future be relieved to a considerable extent of the necessity of bearing the brunt of the old fashioned type of American money shortage.

In the second place, the future of American industry, dependent as it always is upon obtaining adequate capital for growth and expansion, is now plainly up to the American investing public alone. Certainly, for many years our domestic business enterprises cannot look for assistance in the capital markets of Europe. The financial machinery of this country must therefore be made ample and sufficient to provide capital regularly and smoothly for the steady normal growth of American business.

In the third place, the New York Stock Exchange security markets have become a stabilizing factor not only to business and economic conditions in this country, but in a measure to the whole modern world. In recent years no class of listed securities has experienced a more rapid proportional growth than that which represents the borrowings of foreign governments and foreign business enterprises in the United States. On the first of January, 1926, there were 116 foreign government bonds listed on the New York Stock Exchange, of which 3 were Asiatic, 7 were Australasian, 58 European, 17 North American and 31 South American. In addition there

were listed on the same date 44 security issues of foreign railway companies, and 46 issues of foreign non-railway companies—making a total of 206 foreign issues listed on the Exchange. Many economists believe that this section of our listings is destined to experience a broad growth in future years. In proportion as the New York Stock Exchange undertakes to market and to carry such foreign securities, it perforce becomes subject to the economic strains and crises arising in foreign countries, and thereby extends its influence as a stabilizing factor in finance and in business to the debtor nations of the world. For many years just this situation obtained on the Stock Exchange in London. In 1907, because of the great international interests of the British credit center in the then debtor United States, our own panic was immediately reflected by conditions of strain in London, and London on that occasion did much to mitigate the force of the panic as it was felt in this country. It is unlikely that, for many years at least, foreign securities will prove anything like as great a proportional influence in New York as they were in London before the war. Nevertheless the international creditor position of the United States today compels American business men to realize that upon the staunchness and efficiency of our own machinery of credit, both stability and prosperity in the foreign debtor nations must in coming years largely depend. The stability of American business has thus become a fundamental factor in the stability of conditions throughout the modern world, and in few places in this country is this new development more clearly and immediately manifested than upon the floor of the New York Stock Exchange.

VII.

I therefore return to my original comparison of American business with a great ocean ship driven by very powerful and at the same time very complex machinery. Just as the ocean liner represents a long evolution from the old packet ships of 75 years ago, just so our credit machinery, which is so largely the driving and guiding power of American business today, has come a long way in the past half-century toward ever greater efficiency and stability. The early money and security markets in this country were also subject to every random wind, were constantly blown off their course by the force of circumstances, and could rarely keep to any stable schedule. When today we take passage for Europe on a great modern ocean liner, few of us recall that the victories of the ship's machinery over these previously insuperable obstacles were only gained after boilers had burst, driving rods had cracked, and practically every part of the ship's engines had tasted strain and even disaster. The evolution experienced in the American banking and security markets has been equally strenuous. The comparative perfection of our present day financial machinery has resulted only after civil and foreign wars, panics and booms, periods of great prosperity and periods of bitter adversity. American finance has still very much to learn, and many refinements still to introduce in its operating machinery. Yet, however the economic winds of the future may veer and change, we are justified in believing that never again will the disasters of the past re-arise in American business to so far deflect us from our course, or so far imperil the safety of our voyages and our traffickings. Steeled and fortified by its own past hardships, the great stabilizing mechanism of American finance can face the coming years with a high courage and a calm assurance.

LISTING SECURITIES
ON THE
NEW YORK STOCK EXCHANGE

*Address before the Mississippi Valley Group,
Investment Bankers Association of America,
at their Annual Dinner at the
University Club, St. Louis, Mo.,
March 23, 1926*

LISTING SECURITIES ON THE NEW YORK STOCK EXCHANGE

Two generations ago American business was for the most part carried on by men who were accustomed to meet very frequently. Transportation and communication were still undeveloped. The mountains and rivers, the prairies and forests of our great continent still retained their perennial mastery over man. In our own times, the railroad, the telegraph and the telephone have almost entirely removed this historic limitation upon American trade. We all carry on business with individuals and firms known to us primarily by name and reputation, rather than by personal contact. And yet something has gone out of business as we conduct it today. The touch of personal confidence is apt to be lacking. Misunderstandings arise more easily and persist more stubbornly, so that after all it is desirable for those of us who are engaged in business on a national scale, to travel and to meet our clients and competitors in person. This fact must serve as my excuse for appearing before the Mississippi Valley Group of the Investment Bankers Association to talk to you upon the New York Stock Exchange.

Among the many activities of the New York Stock Exchange which are commonly misunderstood, few are of more vital importance to investment bankers than the policy of the Exchange regarding the admission of new securities to its trading facilities. Instead of speaking to you regarding the general functions and character of the Stock Exchange, therefore, I would like to seize this gratifying opportunity to describe and explain to you in some detail the listing policies and proce-

ture of the Exchange. Inasmuch as I am addressing here tonight a group of men engaged in the same general business as that of the members of the New York Stock Exchange—namely, marketing and distributing securities—I felt at liberty to discuss this whole subject in a somewhat more technical manner than would be advisable with an audience of laymen.

II.

One of the essential features of the present listing procedure on the New York Stock Exchange which is seldom realized by the layman, is that it has grown up only after the varied experience of almost a century. Since financial evils against which some of its provisions were very effectually aimed have today largely disappeared, one must possess some knowledge of financial history to appreciate it fully. It is thus necessary to outline briefly how our listing procedure evolved, before its present status can be adequately explained.

Prior to 1817, the stock market in New York was conducted in the open street under a loose organization which did not permit of effective regulation regarding the details of the business. Moreover, the principal securities bought and sold in these early years were bonds of our Federal and State governments, which for patriotic reasons were very naturally accepted for trading without any especial scrutiny. In 1817 the Stock Exchange moved indoors, formed a more effective organization, and gained potentially great disciplinary powers over its members. By this step, it became for the first time possible to select the securities in which trading was permitted, although this power was not immediately invoked because of the preponderance of American government issues. In the '30s and '40s, however, the first securities of American railway companies appeared in the New York Stock

Exchange market. At that time, railroading was of course a completely new industry, and little understood even by those who controlled and operated the roads, let alone by the security investing class generally. Railroad securities were at first intensely speculative, and public complaints over their lively and erratic performances in the market soon began.

Prior to the Civil War the New York Stock Exchange was still, by modern standards, a very small and rather local institution. The market was conducted somewhat after the fashion of a modern auction; the chairman of the Board would successively call out the name of the market's favorite securities, one after another, and trading would follow the "call" in each instance. On the request of a few members, new securities could at almost any time be added to the list "called" in this way. Thus the New York Stock Exchange through this period exerted little discrimination in the securities admitted to its market, and had no hard and fast rules concerning the admission of new securities to its list. Under this system—or lack of system—little could be done for the time being to obtain extensive or reliable information regarding the Exchange's listed issues, either in behalf of Exchange members themselves or their clients, the investing public.

With the continued growth of the market, a committee of Exchange members was at length appointed to take charge of this whole problem of admitting new securities to trading and quotation by the New York Stock Exchange, and here the efforts of the Exchange to supervise and control its listing policies in the interest of the public really began. The early committees faced a problem at that time extraordinarily difficult. The leading corporations of the day considered the facts and figures relating to their operations entirely their

own business, and no concern at all of the public, or even of the stockholders. American industries of all sorts were still in the pioneer stage, and inevitably were managed in a freer and more individualistic manner than would be tolerated today. For the time being, the element of stability was mainly lacking not only in shares but even in the bonds of the early American railroading, mining and industrial corporations.

Moreover, the New York Stock Exchange was an entirely private business organization, which had no way of compelling corporations to give publicity concerning their affairs except by refusing to list them upon the Exchange. The existence of competitive markets, not only in the other leading cities of the country but also in New York City itself, rendered such a refusal to list an even more imperfect method of compulsion than it is today. The New York Stock Exchange was therefore in no position to constitute itself an arbiter of American corporate practice, or to assume immediately an inflexible attitude regarding requirements for listing which have subsequently come to be taken by American business corporations as entirely justified, and indeed a matter of course. The listing policy of the New York Stock Exchange in consequence had at its command only the employment of moral suasion, to induce the leading corporations of the day to make public the essential facts of their current status and operation.

On the other hand, it is well to understand the exact position of the New York Stock Exchange even in these early days. Since the bulk of its membership was composed of brokers acting as agents for the public, the interest of the Exchange regarding corporate publicity was fundamentally identical with that of the American investing public. Moreover, the market for securities on the New York Stock Exchange was constantly grow-

ing, and constantly affording to American business companies a more and more effective method of obtaining the large capital sums which they needed for growth and expansion, by the sale of their securities to American investors. This practical value of the New York Stock Exchange, as a facility for distributing corporation bonds and shares, in the long run proved one of the earliest and most potent factors in dispelling the original secrecy which surrounded American corporate affairs, and in leading our principal corporations to adopt step by step a policy of taking the investing public into its confidence. The course of this gradual evolution toward wider corporate publicity was very slow, particularly in the beginning, and has by no means reached an end even in our own day.

But apart from the initial unwillingness of American corporations to reveal the essential facts concerning their business, the New York Stock Exchange also encountered another almost equally difficult problem—the question as to just what facts and figures it should require for listing. Very obviously a mining company's securities could not be analyzed in exactly the same way as those of a railroad company, or those of an industrial corporation the same as those of a shipping or merchandising enterprise. Certain standards and requirements could be and were developed by the Stock Exchange for all companies alike, but in addition it became necessary to formulate special requirements for some of the leading and distinctive forms of business enterprise. For example, the Exchange's present requirements concerning mining securities embody certain special suggestions from the Metallurgical Society, while its requirements for petroleum securities similarly contain expert suggestions made by the American Institute of Mining Engineers.

In thus developing specialized listing require-

ments for particular industries, it should also be realized that the New York Stock Exchange very naturally could not and still cannot formulate such technical codes in advance of industrial experience. Frequently it is not until the securities of a given industry have been extensively traded in for ten or twenty years, that sufficient experience is available to the Exchange to allow the formulation of a special technical code of listing requirements for it. As late as 1910 the New York Stock Exchange maintained what it called an "unlisted department," where the securities of manufacturing and other industrial corporations could be bought and sold under listing requirements which were considerably relaxed. Subsequent experience has, however, made this tentative arrangement no longer necessary.

This process of specializing our listing requirements to cover more adequately new classes of securities appearing on our list is still going on. Last year, for example, a special section of our listing requirements was formulated to cover foreign government bonds. Until recent years, the important government bond issues listed on the New York Stock Exchange had been so largely those of our Federal, State and City governments, that naturally no extensive listing requirements were sought in their case for patriotic reasons. The rapid listing of many new foreign government issues after 1915, however, made it necessary to formulate a special listing code for this relatively new type of security. As yet, however, the experience of the American financial markets with foreign government bonds is still too brief and limited to allow the New York Stock Exchange requirements for this class of security to attain a final or inflexible form. Undoubtedly in future years similar special additions to the requirements will have to be made in the instance of new classes of securities as they

appear on the list. Nevertheless, our listing requirements and our listing procedure as a whole have been enforced for a great many years, and therefore have already developed from the gristle to the bone in most cases.

One final point concerning this slow and steady evolution of the listing requirements of the New York Stock Exchange should be noted. Primarily it has been a development initiated, fostered and carried out entirely by the New York Stock Exchange itself. To some extent the trend toward government regulation of industry has made the Stock Exchange's task easier. The extensive requirements of the Interstate Commerce Commission for current operating figures of American railroads, the facts sought and made public concerning our national banks by the Comptroller of the Currency, and the similar publicity brought about in the case of utility enterprises by the various commissions of our different States, have been important factors in the increased enlightenment of the investing public with regard to the outstanding American corporate securities of today. Nevertheless, the New York Stock Exchange is justified in claiming credit for initiating the movement in the first instance, and for developing it impartially among the different business enterprises of the country to the utmost of its ability and power during almost three-quarters of a century.

III.

With this background of past development, we can now consider the listing procedure of the New York Stock Exchange as it stands today. At the outset, I would point out that the Exchange has never made it a practice to solicit listings from American corporations. Such a practice, it has been felt, would run contrary to the public interest,

in that it would involve an apparent endorsement of the issues thus solicited by the Stock Exchange, and would as a result make the enforcement of our listing regulations more difficult. The Stock Exchange has thus always preserved an impartial, judicious and disinterested attitude toward new applications for listing. In consequence, only those corporations have listed their securities on the Board, who have on their own initiative applied for such listing.

The further question as to why given companies have never applied in this way to list their securities on the New York Stock Exchange, can best be answered by the companies themselves, since very naturally the Exchange is not in a position in most cases to know anything about the matter. There is of course no legal or economic compulsion about listing on the Exchange. It is purely a question of the advantage to be derived from the step by the given corporation, and this advantage varies somewhat with different companies and with different industries. Sometimes the wider distribution of shares brought about by admission to the Stock Exchange market is considered undesirable by the existing shareholders. Sometimes the company in question is unable or unwilling to comply with the Stock Exchange listing requirements. These listing requirements, I might add, are furnished on request to the public and are perfectly well known in financial and business circles. Many companies thus know very well that they could not comply with the requirements successfully, and consequently never make the attempt.

In the New York Stock Exchange, questions of admitting new securities to the list are handled by the Committee on Stock List, which is composed of five governors of the Exchange. It is a function of this Committee on Stock List to receive and consider applications for the listing of new security

issues and to refer them, if approved, to the Governing Committee of the Exchange as a final authority in the matter. At the outset the applicant company, as represented by its own officers, its counsel or its bankers, is furnished by the Committee on Stock List with three separate forms to be filled out and submitted to the Committee. Each of these forms plays an important part in the listing process, and even at the expense of going somewhat into detail, I wish briefly to explain each of them.

The first form—known as the “distribution statement”—requests the company to state the various amounts of its shares held in blocks of different sizes from 100 to 1000 shares and up, and also the number of shares held by the ten largest stockholders of the concern. The Stock Exchange is not interested in who the stockholders are, but it requires assurance that the shares shall be sufficiently distributed before listing to permit the establishment of a free and open market for the new security on the Stock Exchange. With the same purpose in view, the company is required to give assurance that “all stock is free for sale and is held under no syndicate, agreement or control.” Because of this requirement by the Exchange that new stock issues applying for listing upon it must already have a fair preliminary distribution, it is sometimes necessary for very sound companies to list and distribute their shares on the New York Curb market, or on some other preliminary market, prior to their admission to the floor of the New York Stock Exchange.

The second form—called the “questionnaire”—contains a series of questions whose answers establish the relationship to the corporation of the person or persons applying for a listing, and other miscellaneous matters. On this form the New York Stock Exchange endeavors to secure the agreement of the applicant corporation to publish quarterly statements as to its earnings.

This question of quarterly earning statements has been frequently discussed, and I would like to linger on it for a moment, in order to state the exact position of the Stock Exchange toward it. I have pointed out that the listing procedure of the Exchange represents a long evolution from lax and scanty to extensive and thoroughgoing requirements. Years ago the Exchange did not insist upon quarterly earning statements to the same extent that it does today, and therefore the agreements between the Exchange and the companies whose securities have long been listed upon it, do not always specify any such condition. In consequence it is difficult for the Exchange today to change these agreements in this particular respect. Some companies also object to issuing quarterly earning statements, on the ground that it would place them at a disadvantage with competing concerns who did not do likewise. Also, concerns having foreign properties or subsidiaries sometimes complain that the making of such frequent earning statements involves serious practical difficulties. Another common objection is that some concerns do a very seasonal business, with large earnings at one period of the year and with low earnings or actual deficits in other months, and that consequently the publication of the quarterly earnings of such corporations would tend to alternately excite and alarm shareholders and lead to unnecessary price fluctuation and speculation in the shares of these companies on the Exchange.

In general, however, it can be said that the entire trend in American corporate practice is toward more frequent earning statements, and that year by year, the above and other objections to it possess less and less actual weight. Nevertheless, there is no simple way for the Stock Exchange to bring about a complete transformation of the present situation, where many listed companies report their

earnings only annually or semi-annually. The power of the Stock Exchange, in this as in other such matters, is more circumscribed than is often supposed. The Exchange cannot invariably deny the facilities of its national market to companies which in other respects are entirely willing to abide by its listing requirements. Moreover, in case listed companies show an unwillingness to live up to their agreement with the Exchange respecting the publication of frequent earnings, the latter institution is placed in an embarrassing position. It can, of course, strike the shares of the company from its list, but this action penalizes not only the corporation itself, but also its shareholders who have perhaps purchased its stock on the assumption that they could sell it again on the Exchange whenever they desired. Fortunately such cases are exceptional at the present time. But, in insisting upon as frequent earning statements as possible, the Exchange needs, and I feel deserves, the support not only of bankers and investors but also of American public opinion in general. It is to be hoped that the public will come to take a more direct and more vigorous interest in just such questions as these.

The third, and by far the bulkiest, document involved in applying for a listing on the New York Stock Exchange, is known as the "list of requirements." This contains the rules governing the preparation of the actual security certificates for which contracts are to be made on the New York Stock Exchange floor. When it is realized that the aggregate listings on the Exchange today, exclusive of U. S. Government bonds, amount to over fifty billions of dollars, it will be readily appreciated that great care must be exercised against forgeries of listed stock and bond certificates. The Federal government, in order to safeguard American paper money against the forger, was com-

pelled to establish its Bureau of Printing and Engraving. The New York Stock Exchange has not gone as far as to similarly engage directly in the business of printing and engraving security certificates, but it has insisted that only engraving companies officially approved by it may prepare stock and bond certificates which are to be listed on the Exchange. Elaborate technical precautions must be taken against the over-printing of listed security issues. It is also required that each certificate shall be printed from two overlapping steel plates, in order to prevent forgers making photographic imitations of the certificates. The Exchange also requires that certain outstanding facts regarding the given security issue must be printed plainly on the face of its certificates. The best proof of how effective these various regulations are, is the comparative rarity of forgeries of Stock Exchange listed securities. The regulations of the Exchange in this regard have, in fact, been so successful that many people forget that there is any forgery problem to be dealt with at all.

Another feature in the list of requirements is the rules governing transfer and registry of listed issues. The Stock Exchange requires each company desiring to list its securities on the Exchange, to maintain in the Borough of Manhattan, New York City, two offices or agencies, one for the transfer and the other for the registry of the securities in question. A corporation may prefer to maintain its own transfer office, or it may appoint a trust company to perform the work for it. But no corporation can act as its own registrar, nor can the same trust company act as both transfer agent and registrar for the same security issue. Thus the registrar acts as a check on the transfer office or transfer agent, and eliminates the danger of over-issuance of stocks or bonds. The registrar is in fact the representative of the Stock Exchange, and is by virtue of the

listing requirements under the Exchange's control. These regulations of the Exchange, aimed at the old evil of over-issuing corporate securities, have proved so effective that the possibility of danger from this source has been very largely forgotten by the general public.

But the main body of the list of requirements is devoted to eliciting essential information regarding the applicant corporation which the investor must have to form for himself an adequate opinion of the proper investment value of its securities. The information sought places particular stress on the capital structure of the corporation, and the exact relationship in this structure of the security issue to be listed, the company's assets and liabilities, its earnings and dividend payments, past and present, and many other such vital elements in its business. The specific questions on these and other such matters which the Exchange asks, have been formulated only after the long experience of the New York Stock Exchange and its Governing Committee with securities and security marketing. As already pointed out, the questions are varied somewhat according to the character of the enterprise in question, and in general there has been a tendency toward more specialized questions for the various distinctive industries.

The range of corporate affairs probed by the listing requirements of the New York Stock Exchange tends constantly to increase, as our experience enables us to find ways of widening and extending the service thus rendered to the American investing class. A case in point has already arisen, over the marked tendency of companies in late years to issue common stock without voting power. On January 27th of this year the New York Stock Exchange put itself on record as opposed to the abuses which might possibly arise from this relatively new corporate practice. It is true that the

Exchange's statement regarding this matter was couched in general terms only, and that it merely declared its intention to take cognizance of the non-voting feature of common stocks, without attempting to formulate a definite policy at once. As I have already pointed out, the Exchange cannot well expand its specific listing requirements in advance of adequate experience, and the issuance of non-voting common stock is a relatively new development in this country. The problem of non-voting stock cannot in actual fact ever be settled on paper merely by logic or dogmatic conviction. It must depend for its ultimate solution upon an open-minded development of precedents based upon concrete circumstances and specific cases. While the Stock Exchange has made no positive and irrevocable rule against the listing of non-voting common stock, it intends to inquire into such issues when they apply for a listing, and it will refuse to open the facilities of its market to issues wherein an abuse of this practice seems likely to occur.

IV. .

Having considered the past growth and present status of the Stock Exchange's listing requirements, we can now turn to the methods followed in passing upon applications submitted to the Exchange. While the applicant company is preparing its listing application, the Committee on Stock List stands ready to assist it by explaining the technical provisions of the requirements. In this regard, the listing requirements form contains the following definite and significant statement, "The employees of the Committee on Stock List are instructed to assist in the preparation of applications to list whenever so requested. No charge will be made for such service."

When the application is finished, it is submitted

by the company to the Committee on Stock List, which sets a date for a hearing upon it. A notice is at once posted on the Exchange floor, in order that Exchange members who have any knowledge concerning the issue under consideration can impart it to the Committee, and thus assist the latter in its deliberations on the subject. On the date set, the representatives of the applicant company appear before the Committee on Stock List, and after the hearing the Committee gives or withholds its approval of the issue for listing. If the issue is approved by the Committee on Stock List, the application is then placed before the Governing Committee of the Exchange with the recommendation that the application be granted. The Governing Committee completely retains its power to hold up or refuse its approval in the matter, and not infrequently exercises this power.

The approval of the Governing Committee is the final authoritative step necessary in the Exchange for the listing of a new security issue. Generally a notice that the listing application has been granted is sent out over the ticker, the new security is assigned to a trading post on the floor and is given a ticker symbol, and trading in it starts the day after the action by the Governing Committee. In some cases, however, special circumstances make it desirable to delay the beginning of trading in the new issue until some subsequent date.

But the work of the Stock Exchange is not concluded after the new security has been officially listed. The Stock Exchange must see that the corporation lives up to its agreements in the matter, particularly with respect to the publication of current earnings. The New York Stock Exchange makes no attempt to keep a permanent file of earning statements, balance sheets, or other such material. It, in fact, refuses to receive any statements from the corporation which cannot be made avail-

able to its stockholders or the public. The whole aim of the New York Stock Exchange in its continuing supervision along this line, is to see that listed corporations publish their earnings as promptly and fully as possible, and thus make them available to everyone in the country on an equal basis.

In its agreement with a corporation listing securities on its floor, the New York Stock Exchange always retains the complete right to suspend trading in any issue at will, or even to strike any issue permanently from its list. The retention of this power by the Exchange is a practical necessity from many standpoints, especially, of course, to obviate or minimize the danger of a corner. I cannot at this time go into the complicated subject of security corners as fully as I could wish. I would only stress the fact that the Exchange is primarily concerned with the maintenance of a free and open market which a corner, of course, serves to destroy. The Exchange refuses to allow its facilities to be employed by any individual or set of individuals whose motive is to profit by the cessation or obstruction of the free and open market in any of its securities, and this attitude is very obviously in complete conformance with the real interests of the American investing public. The very size of the present day Stock Exchange system makes the problem of corners one which must be continually kept in mind by the officers of the Exchange. Today there are something like 3500 Stock Exchange brokerage offices, branch offices, and correspondent firms. If simultaneously each of these offices should sell only 300 shares of stock, the large aggregate of over 1,000,000 shares of stock might speedily be rolled up. Solely for this reason, the Stock Exchange will often refuse to list a small stock issue in the first instance, and if a large issue becomes for any reason considerably reduced in amount after listing, the Exchange will scrutinize its market career with

great care, and when advisable suspend trading in it or strike it from the list. It is not so much the function of the New York Stock Exchange as that of the smaller and more localized stock exchanges throughout the country, to make a market for stock issues of comparatively small size.

A final factor in the daily work of the Stock Exchange in connection with its listing lies in supervising the constant changes in the amounts of the many issues on its list. This, of course, involves a huge amount of technical detail, not always realized even by Stock Exchange members themselves. The amount of securities listed changes constantly, not only by whole issues admitted or stricken at one time, but also by small amounts of issues already listed, added or withdrawn from the list. Between 40 and 80 different listed issues change their amounts on the list in this way every day. Bond amounts are reduced by such factors as conversion and sinking fund retirement, while stock issues may be expanded by rights and stock dividends, and either increased or decreased by exchanges of securities during reorganizations. The Stock List Committee must keep in touch with the registrars of over 1000 separate stock issues alone, in order to safeguard the public interest by a proper supervision of changes which, often inconsequential in themselves, are of great significance in the aggregate.

V.

At the outset of my remarks, I pointed out that the listing procedure of the New York Stock Exchange, especially in some of its wider aspects, has been very frequently misunderstood and misinterpreted. I now wish to call to your attention some of the principal problems which the Exchange must face in conducting this work, and to say just a word

of explanation regarding the attitude taken by the Exchange in these matters.

First of all, there is the old and very fundamental question of the practical significance of listing to the actual investment value of securities listed. We all realize clearly the great need of some easy measure of value for security investments. The ordinary investor very often refuses to study the science of investment, or the complicated data connected with any given investment security. He wants a short-cut, and he is only too likely to settle on listing by the New York Stock Exchange as a substitute for investigation and analysis on his own part. Unfortunately, the determination of investment values is a much more complex affair than this. Very naturally the New York Stock Exchange cannot essay the role of an infallible expert on investment matters—to say nothing of the role of a prophet on investment values. The Stock Exchange has no voice in the management of the companies, listed on its floor. It has no means of telling in advance what corporation managers may do, or what special economic tendencies may arise in American business—both determining factors in the success or failure of almost any security investment. It is even impossible for the Stock Exchange to verify completely the accuracy of the statements made to it in the listing applications of American business corporations. Fortunately, little difficulty is as a rule experienced from this source, although in specific instances incorrect statements have been foisted on the Stock Exchange no less than on the American investing public.

Under these circumstances, the fact that a given security is listed on the New York Stock Exchange cannot be taken as any guarantee or special endorsement of the security by the Exchange. The only cases on record where the Stock Exchange has actually urged investors to buy specific securities,

have occurred in connection with the flotation of U. S. Government bonds in various governmental crises, and this has, of course, been done through purely patriotic motives. Yet the danger which the Stock Exchange runs in specifically endorsing any security was shown very clearly in recent years with the Liberty Loans. In spite of the fact that these Loans were unanimously admitted by the best investment experts to be the safest security in the world, nevertheless they sold off about twenty per cent shortly after they were issued, and caused large losses to thousands of people all over the country. When such an experience could be had with an admittedly gilt-edged security, the possible results of a similar endorsement by the Stock Exchange of the ordinary run of securities need not be commented upon further.

Apart from these considerations, however, it is a real question with stock exchanges, not only in this country but all over the world, how far they should attempt to limit their listings to only high class investment securities. Only legitimate securities, of course, should be admitted for trading on a stock exchange. But this distinction is of little practical value in answering this oft-repeated question. If only the highest class investment securities are listed, the inevitable result is to compel ordinary securities to be marketed somewhere outside of the standard organized stock markets, where dealings are not as well regulated and the public is not to the same extent protected. On the other hand, it would be equally undesirable to attempt to list all legitimate securities indiscriminately. To be sure, the argument is sometimes made that weak securities need just as good a market as strong ones, that regulation of corporate securities is the business of the State rather than that of the Stock Exchange anyway, that the stock exchanges should therefore confine their efforts entirely to maintaining a legiti-

mate market, and let the buyer beware here as he must beware in practically all the other fields of trade. Of course there are, at any given time, bound to be large amounts of perfectly legitimate but uncertain and speculative securities outstanding, and undoubtedly in the public interest, these securities need a good marketing system even more than the gilt-edged securities which, as the saying is, practically sell themselves. Nevertheless there always remains the serious difficulty that the facilities of the Stock Exchange might be employed for the purpose of bringing prominently to the attention of the American investing class, securities likely to cause considerable losses to those who buy them.

Between these two extreme positions, the New York Stock Exchange must compromise according to the merits of each individual case. The Stock Exchange is on unassailable ground, at any rate, in endeavoring with all its power to make available to the public information concerning its listed securities, sufficient to permit American investors to judge adequately concerning present and prospective investment values for themselves. Undoubtedly the most important function of the listing operations of the Exchange, as far as these relate to determining investment value, is to further corporate publicity and the wide publication of essential facts and figures regarding the securities admitted to our list.

The listing problem of the New York Stock Exchange is all the more difficult and burdensome because of the peculiar situation in this country regarding the incorporation of new companies, as compared with that prevailing in the leading nations of Europe. Abroad, companies are almost always incorporated by the central government alone. In consequence, a single statute can be drawn up to cover the entire matter in each country, and thus the problem of careless or fraudulent incorporations

can be readily attacked. Great Britain has, for example, a single statute—the British Companies' Act—in accordance with whose provisions all companies incorporated there must equally conform. In the United States, however, the power to incorporate business enterprises is almost always exercised by our States rather than our Federal government. Owing to this fact, we have forty-eight separate incorporating statutes, rather than simply one. Students of finance and business have often claimed that the situation in this country leads to a fatal ease in incorporating completely fraudulent enterprises, as well as to a lack of definite regulations attending the creation of legitimate business corporations here.

Owing to this complex and unwieldy situation in regard to American incorporation laws, there is unusual pressure on the New York Stock Exchange, as the leading American organized security market, to set up national standards for such matters in its listing requirements. This has in turn led to our listing requirements becoming in general much more extensive and thorough than those of practically any of the other leading stock exchanges of the world. To a large extent the major stock exchanges abroad can pass the responsibilities for their listings back on the government—an easy escape from a problem which the New York Stock Exchange is daily compelled to face almost entirely on its own responsibility.

The difficulties of the New York Stock Exchange in this respect have not been lightened by some critics who have been most enthusiastic in respect to the way its listing problem is regularly handled. It has, for example, been sometimes urged that the Stock Exchange undertake a policy of regulating American business corporations, through the leverage of its power to admit or refuse admittance to companies applying for listing. This view of the

matter, however, is a dangerous fallacy. The New York Stock Exchange, to begin with, is a private organization, and as such is not a suitable means for the performance of an obviously public function. The basic purpose of the Exchange is, after all, simply to maintain a marketplace for securities, and very naturally, it is by no means equipped to undertake any policy of controlling American corporate practice. But even if the Exchange were to undertake such a public function, it could not successfully carry it out, because it lacks any sufficient power to enforce its decisions. In respect to security marketing, the New York Stock Exchange holds no monopoly either of an economic or a legal character. The only power at its command in specific instances, consists in its ability to strike a recalcitrant company from its list—an action which might well hurt security holders as much as, or more than, it would the corporation itself. The Stock Exchange has therefore wisely restrained its activities within the boundaries of its natural function—to maintain a free and open market for security issues.

Similar and equally important reluctance to extend unduly the desirable scope of government regulation of business, has likewise been shown on many occasions by our government. The Federal government has many times recognized the undesirability, in the public interest, of attempting to regulate the listing of securities on the stock exchanges of this country. One very important reason why the New York Stock Exchange and the Stock Exchange of London are today the two greatest organized security markets in the world, is because both these exchanges have confined themselves strictly to their business, and because both the American and British governments have declined to meddle needlessly in their affairs. A less far-sighted policy has been followed by some

of the leading stock exchanges and governments on the continent of Europe, with results which have by no means been comparable, as far as protecting the investing public goes, to those achieved by the American and the British policy of depending on private initiative, rather than governmental regulation, in business affairs.

VI.

The United States, as we all recognize, has since the war become an international creditor nation. In respect to its foreign financial and trade relations, it has attained an economic status which some of the older nations of Europe reached almost a century ago. One of the interesting signs of this dramatic transformation of the United States from debtor to creditor, has been the heavy purchasing and distributing in this country of foreign government and corporate securities. New opportunities for financial service have thus been opened to the New York Stock Exchange, as well as the new responsibilities which attend them.

Our experience with the problems arising from investment in foreign securities is, of course, very recent, and undoubtedly our methods of handling some of these problems are for this reason still inadequate. It is difficult for Americans without considerable foreign experience to readily grasp the complex factors present in foreign business and finance. Instances have occurred where American underwriters have rushed abroad to put through "deals" involving new foreign loans in this country, without adequate knowledge of the facts underlying the prospective securities. American investment firms have been sometimes swayed more by the lure of ready underwriting and distributing profits, than by the actual character of the issues in question. The American security business has not infrequently

taken full advantage of the familiar disclaimer printed at the bottom of new security offerings—"We believe the foregoing facts to be true, but we cannot guarantee their accuracy". Thus far, it must be admitted, no particular damage has apparently been done, yet many of us, I think, have a feeling that we have much to learn concerning the proper issuance and distribution of foreign securities in this country.

I have already referred to the special code for foreign government bonds recently added to the Stock Exchange listing requirements. The leading security underwriters have cooperated with the New York Stock Exchange, in rendering this addition to our listing requirements a source of valuable information to the investors of this country. It may well be, however, that in the course of time the Stock Exchange requirements for foreign securities will have to be expanded and refined in the light of a more extensive experience. There is, furthermore, an apparent need for more thorough investigation of the facts attending new foreign loan issues, by American investment bankers. It is my hope that the Stock Exchange and the investment banking fraternity can, by a policy of further cooperation in this matter, render a real and much needed service to the countless small investors of the country who are now so generally purchasing the obligations of foreign public and business enterprises.

VII.

From the very beginning, it has been primarily in behalf of the American investing public, that the listing requirements of the New York Stock Exchange have been formulated and enforced. To attain the greatest possible effectiveness and public usefulness, our listing policy calls not only for the unceasing vigilance of the New York Stock Exchange itself,

but also for the hearty cooperation of the investors and dealers in investment securities all over the United States. The New York Stock Exchange is most anxious in this matter to have the benefit of suggestions and constructive criticism of the public. The Exchange particularly needs the cooperation and sympathetic understanding of American investment bankers, in maintaining and constantly bettering its listing requirements.

Not the least significant aspect of the Stock Exchange listing procedure is its important bearing on the old question of security speculation. You gentlemen realize as clearly as I do, that financial speculation arises from the inevitable human attempt to measure and estimate a future which must of necessity be unknowable. I imagine that we are all fairly in accord, in defending security speculation as an economic force which has vastly expanded the productive facilities of this nation, which has enriched our material existence at a thousand points, and which, in the long run, has served to stabilize financial and trade conditions. Yet, like some of the beneficial forces in the physical world, speculation can be an indispensable servant but a bad master. Electricity can inflict damage as well as illuminate our homes, and gas can cause explosions as well as cook our food. As a matter of fact, speculation in securities is to some extent only a temporary substitute for scientific investment knowledge and analysis. The real way to obviate the excesses of speculation is to replace ignorance concerning economic facts and figures, by definite and accurate knowledge. It is here that the listing machinery of the New York Stock Exchange renders constructive and beneficial services to the entire public of this country today. It can elicit with a fair degree of completeness the essential facts concerning the principal security issues outstanding in this country. But the further

task of making these facts readily available to the entire public of the country remains, and here not only the cooperation of our press, but also that of the nation's investment bankers, must be invoked.

During the past century, American finance has vitally assisted in building the greatest productive, manufacturing and mercantile nation in the world, largely through mobilizing the greatest and wealthiest army of security investors that any nation has ever seen. Yet, great though these achievements undoubtedly be, our task is still only half done. We must press ever forward in rendering security investment in the United States not only more extensive but also more safe and stable than in any country in the world. We must surround the process of security investment in this country with every safeguard that ingenuity, experience and financial research can suggest. So far as the longer experience of the older European financial centers affords practical precedents for us, we must seize them. But where the experience of Europe sheds no light upon our investment problems, we must go forward ourselves, through cautious and conscientious striving and experiment, to build the financial America of tomorrow.

THE STOCK EXCHANGE AND AMERICAN BANKING

*Address before the Annual Convention of the
Investment Bankers Association of
America, at St. Petersburg,
Florida, December 9, 1925*

THE STOCK EXCHANGE AND AMERICAN BANKING

The New York Stock Exchange is a very old institution—one of the oldest, as a matter of fact, in the entire annals of American business. For more than a century, its services as a free and open securities market have been rendered almost continuously available to the investing public of this country. It is altogether natural that today not only the existence but also the successful operation of the Stock Exchange should be simply assumed and taken for granted by most people. Just as few people wish to tear their automobile motor to pieces as long as it runs satisfactorily, so few American business men stop to reflect upon the whys and wherefores of the Stock Exchange machinery or its important economic functions, unless its gears appear to clash. The very success of the Exchange in the past as an open market for securities has consequently been largely responsible for a lack of familiarity with it, prevalent not only among American investors generally but even among American financial men themselves.

A famous British economist, W. S. Jevons, once remarked, "It is a singular fact that markets have been the subject of popular prejudice and moral objection almost in proportion to the perfection with which they economize time, transportation and effort, and equalize prices." This terse statement of a paradox long familiar to bankers is my own justification for appearing before you today to speak of the intimate but often unrecognized relationship that exists between American investment and commercial banking, and the leading organized securities market whose president I happen to be.

I.

The stock market was the first part of our modern financial mechanism to develop in this country because, in many ways, its services were most fundamental and most urgently needed. When the ten or twelve stockbrokers of 1792 gathered under the buttonwood tree in lower Wall Street for the first time, they were unconsciously laying the foundation of a very large portion of the organization of American finance as we know it today. It was the pioneer task of these early stockbrokers, which they themselves sensed only in part, to popularize security investment in this country. Before their time, no such thing existed, and capitalists could find a profitable employment of their funds only through the purchase of real or personal property, or mortgage notes based upon it. In consequence, the initial task of creating a public demand in this country for security issues was a new departure in the business and social life of the community. The early Wall Street stockbrokers, however much they lacked our present perspective upon the security investment business, were nevertheless led by a sound instinct to undertake their collective task by means of a free and open market, where purchasing and selling was carried on in the open at all times, and where as much publicity as possible was afforded the prices thus established. To the inexperienced and naturally timid security investors of the new republic, this free and open security market in Wall Street, although lacking practically all of its modern mechanical equipment and conveniences in the beginning, nevertheless served as a tremendous stimulus and incentive.

Apart from its indispensable work in popularizing the bonds of our federal and state governments, the early services of the New York stock market were especially exerted in behalf of the incorporated banks and insurance companies. It is necessary to recall

that at the opening of the 19th century in this country the banks had not yet become assured pillars of commerce and trade, whose successful existence could be calmly and casually assumed; the early American banking institutions were instead novel, isolated and hazardous enterprises, subject not only to all manner of personal irregularity and eccentricity of management, but also to the acute and constantly recurring economic strains always present in a new and a poor country. Our earliest bank stocks were therefore highly speculative securities at first, and subject to very lively and sometimes disconcerting fluctuations. Nevertheless the continuous operation of the open securities market steadily attracted capital into the banking business, materially assisted in stabilizing banking shares as a popular investment, and thus proved a vital factor in the ultimate emergence of commercial banking as a successful business enterprise in America. The corporate banks in our older eastern cities therefore owe a historic debt to the stock exchanges of New York, Boston and other eastern centers from their earliest days.

As the 19th century advanced, this novel process of attracting capital into business enterprises through the organized securities market was repeated with one new major industry after another. A continuous flood of securities in new enterprises came on the market, which were in turn rendered familiar to American investors and stabilized by the steady accretion of private capital. What the New York stock market had done for government securities and banking shares it proceeded to duplicate in the case of the stocks and bonds of railroads, mines, oil wells, utility enterprises and manufacturing and distributing concerns of all kinds.

In the first few decades of its existence, the New York Stock Exchange, although it rapidly grew to be the greatest market of its kind in the country, was

nevertheless still a largely localized market, due to the insuperable obstacles imposed on its operations by time and space. The development of electric communication over the telegraph, the telephone, and the stock quotation ticker speedily revolutionized this situation, and provided the physical facilities for the creation of a truly national market for capital in New York. With the extension of brokerage wires in all directions from Wall Street, the American business in securities rapidly gravitated into the New York financial center. This evolution of the New York Stock Exchange into a national marketing institution served in turn to standardize the process of American security investment to an important degree, and to place the investors in different parts of the country on a more identical basis with regard to the accessibility of the Stock Exchange floor.

Thus far in the 20th century the Stock Exchange has continued to exert the same economic functions, only on a broader and more complex scale. As old and familiar securities listed upon it have attained stability, new and usually uncertain enterprises involving heavy investment risks have risen to take their place. Our listed securities today accurately reflect the complex society in which we live, and the higher standard of living everywhere prevalent in the United States; already the motor-bus and airplane industries are represented there, and in the field of manufacturing a vast array of new industries which would be totally unfamiliar to the banker or investor of fifty years ago. In addition, the war has given a tremendous impetus to another development in our list, which would sooner or later have become inevitable—the appearance there of a large aggregate amount of foreign securities. On the first of November, 1925, there were listed on the New York Stock Exchange 112 bond issues of foreign governments, 55 of which

pertained to nations of Europe, 30 to nations of Central and South America, 17 to North America and the West Indies, 7 to Australasia, and 3 to Asia. The aggregate market value of these issues appreciably exceeded two billions of dollars, while the total market value of listed securities on the same date considerably exceeded sixty-four billions of dollars.

The magnitude of listings on the New York Stock Exchange today is therefore more than simply a reflection of the present wealth and prosperity of the country—it also indicates how effectually the Stock Exchange has labored during the past century in creating a demand for investment securities in the United States. In the future, as in the past, the Stock Exchange stands ready to serve the needs of the nation as a market for capital, in respect to whatever scientific discoveries or mechanical inventions the coming years may yet hold in store for society. Then, as now and as in the past, the mechanism of the free and open securities market on the New York Stock Exchange will continue to broaden the popularity of investment securities, and to facilitate their distribution among our people.

II.

With the price-making function of the Stock Exchange, and the national value of the publicity afforded its prices, all are familiar. Few, however, outside of the investment business itself, realize in any adequate way how important are the services of the organized security market on the Exchange as an actual agent of security distribution. Bewildered by technical financial terminology, and distracted by the stock market's speculative foam and froth, all too few people realize the steady underlying flow of funds into the capital market, and their ebb into the productive enterprises of the nation.

When a particularly large or in any way uncertain security issue is at first put out, there is not as a rule sufficient genuine investment demand to absorb it all at once. In consequence such issues—and these include the majority of our large scale businesses of modern times—must be sold gradually to the investor, as he becomes persuaded of their stability and their safety. In consequence of this fact there is almost always a “floating supply” of securities which must be bought by speculative dealers and held by them until enough investment demand develops to absorb them. It is therefore the normal thing, with most new security issues, to find a large proportion of them in the beginning reposing in collateral loan envelopes at the banks and, as time goes on, gradually passing thence to the strongboxes of actual and permanent investors. I need not point out to this audience that there is nothing exceptional or peculiar about this aspect of security distribution. Exactly the same thing occurs with merchandise which must be carried on dealers’ shelves before it can be passed from the producer to the consumer. The financing of security dealers is therefore just as legitimate as the financing of mercantile dealers. Indeed, the business of security distribution is only a recently developed species of ordinary commerce.

Because of the character of the goods distributed, however, security distribution differs from the distribution of ordinary mercantile products in two important particulars. In the first place, securities are non-perishable articles, and on this account are more readily subject to resale by investors than are most commercial products by consumers. In the second place, securities are, from the standpoint of the individual, purchased only with surplus funds after the needs and wants imposed upon him by his standard of living have been satisfied; by the same token, securities are the last thing an individual purchases and the first thing he sells when he needs

ready funds, and this fact also tends to occasion frequent resale of stocks and bonds in the market by investors. In consequence, the distributing process in securities is not as regular or mechanical an affair as is the case with most consumers' goods and perishable commodities. Stock distribution especially is a somewhat erratic process which, although in the long run certain and steady in the case of desirable shares, may nevertheless frequently reverse itself for the time being.

An admirable example of this very sort is afforded by the statistics issued quarterly by the Steel Corporation, covering the proportion of its common shares held by brokers and by individuals, which of course, represent more or less accurately the floating supply of the issue as compared with that proportion of it held by private investors. At the outset of 1910 just about $\frac{2}{3}$ of "Steel common" was held in the floating supply, and only $\frac{1}{3}$ by investors. By the beginning of 1914 the market had succeeded in distributing considerable of this stock, with the result that about $\frac{1}{2}$ of the issue was held by dealers and $\frac{1}{2}$ by investors. At the beginning of 1920 the dealers' supplies of "Steel common" had fallen to a still lower proportion, and about $\frac{1}{3}$ of the issue only was held by them, and the remaining $\frac{2}{3}$ by investors. Recently there is evidence that the market has continued this steady distribution of "Steel common" among the investors of the nation, who now hold something like $\frac{4}{5}$ of the total issue, as against only about $\frac{1}{5}$ still held by dealers. Nevertheless these records also reveal many temporary interruptions to this general drift of "Steel common" shares from the dealer to the investor over the past 15 years, and some instances where the trend has temporarily been strongly in the opposite direction. But because security distribution is more complex and less mechanical than the distribution of ordinary commercial products, is no reason for

denying its existence altogether or disregarding its vast significance to practically all branches of modern American business. It is not too much to claim for the New York Stock Exchange, that it is the most significant single agency for the distribution of investment securities in this country today, or that any issue possessed of actual and steadily developing investment merit can be most effectually and inexpensively distributed to permanent American investors by the organized security market on its floor.

III.

During the past few decades the major lines of American business enterprise have almost without exception taken on a remarkable degree of stability, compared with conditions in previous years. Not only have our railroad and industrial enterprises evolved from uncertainty into definite and dependable business organizations, but our national wealth and vastly improved banking system have likewise lent an unaccustomed stability throughout the field of American business. This constant tendency toward stability in American business has naturally been reflected in the financial field by the steady transformation of securities formerly speculative into securities of undoubted investment quality. As a result, an economic need has been created for dealers in investment securities as well as in issues of a riskier and more speculative character, and there has consequently emerged a new type of banker whose business it is to deal in long rather than short term securities, and provide fixed and permanent, instead of merely operating, capital to American industry.

The development of investment banking in this country also provided a necessary supplement in security distribution to the facilities long maintained by the New York Stock Exchange. For, as we have

seen, the machinery of the Exchange is better suited to distributing securities to investors gradually over a long period of years than to effect a speedy and immediate distribution of a new issue. The investment banker, on the other hand, is able by his syndicate operations to raise large capital sums for American business very quickly. Also, the listing requirements on the Stock Exchange naturally compel a preliminary distribution of the security issues admitted to its market, and such preliminary distribution requires just the initial supervision and effort now devoted to it by American investment banking firms.

The growth of the investment banking business in this country, as an indispensable link in the financial machinery of the nation, has been very remarkable, particularly in the last decade. No clearer proof of this fact is necessary than this very convention itself, composed as it is of representatives from practically all sections of our great country. But the vital services which investment bankers have rendered, and are today rendering, to the domestic and international business of this nation must not obscure in our minds the very close relationship of their business to the operation of the New York Stock Exchange, which still remains a bulwark to the entire investment business of this country, even in respect to issues not listed at all upon its floor. Without the previous services of the Stock Exchange in popularizing American investment securities and stabilizing the processes of investment in the United States during their most difficult and formative periods, the investment banking business as we know it today could never have arisen. Moreover, the relationship is a continuing one, since in the larger security issues floated in this country banking syndicates limit their efforts to effecting a preliminary distribution only, and leave it to the Stock Exchange to main-

tain the market in such issues and effect a permanent distribution to investors often over a course of many years after the original flotation syndicate has dissolved and been forgotten. The Stock Exchange furthermore provides an open laboratory where the investment banker may witness the effects of present and prospective economic forces on our leading security issues. In times of stress, the Stock Exchange likewise provides a shock absorber for the entire investment industry in this country, by maintaining a liquid market where listed securities can be sold—if necessary to protect holdings of other non-listed and for the time being unsalable security issues. When, in the severe financial crisis which followed the outbreak of the European War in 1914 the Exchange was forced to close its doors for a few months, the investment banking business likewise found itself paralyzed and burdened with economic obstacles previously unknown in American finance.

Thus the Stock Exchange is today a stabilizing and a centralizing influence of deep significance to the entire investment banking business of the country. Even the sometimes intense speculative activity on the Stock Exchange is, as you all know, mostly bound up with the economic conditions surrounding and governing investment itself. Preoccupied though it may be at any time with essentially speculative business, nevertheless the ultimate service of the Stock Exchange, toward which all such speculative transactions themselves tend, is the distribution of securities among permanent American investors. Hence it comes that today the Stock Exchange and the investment bankers of the country perform supplementary functions. In the past they have time and again fought shoulder to shoulder to widen the investment markets of this nation, to provide funds for the expansion of our ever-growing industries, and to purge the entire investment field of fraud and chicanery. In coming years I feel cer-

tain that this intimate relationship between the leading American capital market and the leading American dealers in capital will not only be maintained, but will be deepened by our mutual recognition of the great tasks which the future so clearly has marked out for us to accomplish.

IV

The daily business of the Stock Exchange is almost as important and significant to commercial as to investment banking, and I wish to take advantage of this occasion to mention a few of the fundamental links that connect our organized securities market with the commercial banking system of this country. In part, the relationship between the Exchange and the commercial banks is one of sentiment and tradition—as I have pointed out, the stock market in its earliest years did much to secure capital for some of our first corporate banks a century ago, when the banking business found the acquisition of such capital an extremely difficult undertaking. Today, however, the members of the New York Stock Exchange compose the largest collective borrower at our commercial banks, and the time and call loans on security collateral which they obtain from the banks have perforce become a highly important feature in commercial banking itself.

Security collateral loans, as a matter of fact, have long proved very desirable and helpful to the lending banks no less than to the borrowing stock brokerage and investment banking firms. As short-term banking investments, they have long possessed an enviable record of safety and actual, as distinct from merely theoretical, liquidity. The call loan market on security collateral provided a liquid center for the American money market, and a central rate-making machinery, during the long years of decentralized banking which intervened between the abolition of the second U. S. Bank in 1836 and the

organization of our present Federal Reserve system in 1914. During all these years, the United States had one of the strongest stock exchange systems of any nation in the world—and one of the weakest and most undependable banking systems. It was natural that the poorly organized National Bank system should have leaned heavily upon the Stock Exchange, and upon Stock Exchange loans, under these circumstances. No one today will argue that this was an ideal system, but at least it was vastly better than no system at all. The situation was very obviously neither created nor sought for by the Stock Exchange itself, although in periods of financial stress when the Stock Exchange market was forced to serve as a shock absorber for our entire banking system, the Exchange was usually blamed, instead of thanked, by shortsighted critics.

As any security dealer reviews the trials and tribulations which chronically appeared in American business prior to 1914, and which so severely burdened the investment business in particular, he surely has cause to congratulate our present Federal Reserve system for the great degree of stability that it has introduced into American finance. Instead of having thrust upon it almost the entire task of stabilizing American finance, the New York Stock Exchange today is able to share this heavy and responsible burden with the powerful, highly organized and thoroughly elastic machinery of credit provided by the Federal Reserve Act. In consequence, the security call loan market of today serves as a valuable support to the efforts of the Reserve system to render American banking flexible and liquid. Ever since the organization of the Reserve system, in fact, the Stock Exchange loan market has served a valuable supplementary purpose by sharing with the rediscount facilities of the new Reserve banks, the function of acting as a shock absorber under conditions of strain in American business.

Perhaps the clearest instance of the value of the security call loan market to American banking and American business generally, was seen in the critical period of deflation which occurred in 1919-1921. "Street loans" reached a peak in November, 1919, after which the developing money shortage caused their liquidation from \$1,500,000,000 to \$1,000,000,000 by November, 1920, and to less than \$750,000,000 by July, 1921. But concurrently the total loans and investments of American banks reporting to the Federal Reserve advanced from roughly \$16,000,000,000 in November 1919 to over \$17,000,000,000 in November, 1920, and then fell off to \$15,000,000,000 in July, 1921. By this drastic 50% liquidation of stock market loans, the banks of the country were able during the critical period of 1919-1920 to heavily increase the accommodation extended to American agriculture, merchandising and manufacturing and to limit the inevitable deflation of these latter loans in the months following, to a reduction of only about 12%.

A further service in respect to the liquidity of commercial bank investments was also performed by the call loan market during these and subsequent years. Many commercial banks found themselves loaded with good but frozen loans of substantial American corporations, which while theoretically short term obligations only, had nevertheless through the period of deflation become in actual fact long term obligations. In many instances, these corporations were able by floating new bond issues to obtain the funds necessary to retire these frozen loans at the banks. But since there was not sufficient investment demand to place all these loans immediately in the hands of permanent investors, this process again compelled the assistance of the speculative dealer, who temporarily carried the new securities with funds obtained from the security collateral loan markets. In this way, the call loan market,

after bearing the brunt of financial deflation from 1919 to 1921, assisted to no small degree in reducing the large aggregate of frozen loans held by our commercial banks during and after this period.

In recent months the large sums being loaned by American commercial banks on the collateral of stocks and bonds have afforded a frequent subject of discussion. Without undertaking any complete analysis on this score, I wish to point out two significant facts—first, that Stock Exchange loans by no means compose the whole or even the major part of this aggregate of security collateral loans now held by our commercial banks; and, secondly, that the recent increase in collateral loans generally can by no means be attributed simply to an expansion of loans in Wall Street on Stock Exchange securities.

In any discussion of the extent to which money today is loaned on security collateral, it will not do to overlook the great and in all probability permanent growth of the security business in this country during recent years, and the expansion in new security flotations all over the United States. Nevertheless, it is quite to be expected that, as time goes on, larger and larger aggregate sums of money will be required to facilitate the work of the Stock Exchange in distributing its listed securities among investors, since the listings on the Stock Exchange are now increasing and have always increased along with the growth of American business itself.

On January 2, 1918, there were listed on the New York Stock Exchange 1,102 bond issues and 627 stock issues. By October 1, 1925, our listings had grown to 1,360 bond and 1,004 stock issues. Thus, in less than eight years the number of our listed bond issues has increased about 25%, and the number of our stock issues has increased about 60%. This indication of the growth in our listings does not of course take any account of the actual size of the issues themselves; through the issuance of rights

and the tendency toward larger and larger financing, the actual growth in our listings has probably been much greater than that indicated simply by the increase in number of issues on the list over this period. On September 1, 1925, the actual market value of our 1,358 listed bond issues was more than thirty-five and a quarter billion dollars, and of our 1,000 stock issues was more than twenty-nine and a quarter billion, making a total market value of all issues listed on the New York Stock Exchange on that date in excess of sixty-four and a half billion dollars. It should be obvious to any one who possesses even the most elementary knowledge of the security business that all this vast aggregate amount of securities has not yet been distributed to permanent investors, but that the process of so distributing them is now going on, and that in consequence a considerable portion of this great total must today be carried by dealers on borrowed funds until sufficient investment demand develops to absorb it. Figures on total Stock Exchange loans today are not available, but certainly such loans total less than 5% of the actual market values of our current listings as above stated. I venture to assert that there are few lines of mercantile distribution which are able to operate smoothly and efficiently with as small proportional bank borrowings as this.

V

The importance of security collateral loans in our commercial banking system of today has very naturally raised once more the old question as to the theoretical functions and the legitimate field of modern commercial banking. It is all the more important to have a clear theoretical idea as to what our commercial banks are for and just how they should operate, since the United States is today the greatest creditor nation in the world, and our

banking system is not only a bulwark, but also to some extent a model to the banking systems of other countries. It is thus particularly important that American banking theory as well as American banking practice should be definite, coherent and realistic, that it should not in any way follow the wandering fires of economic fallacy, or that it should be unduly hampered by out-of-date conceptions or formulas.

It was Adam Smith who evolved the classic formula for the function of commercial banks—that they should finance goods in transit from producer to consumer. Adam Smith's famous masterpiece "The Wealth of Nations," from which so many of our present financial and economic theories date, was published in 1776. It was altogether natural that in Adam Smith's day, when the employment of credit was practically confined to the merchant class, commercial banking should be similarly limited to the financing of merchants only, and that this situation should similarly limit any current theory regarding the proper functions of commercial banking itself.

In the last 150 years, the economic and business conditions with which Adam Smith was familiar have been revolutionized both here and abroad. Credit, originally employed only by the State or by the merchant class, now plays a vital part in practically every known form of industry and enterprise. Recently, systems of extending credit even to the consumer of perishable goods by part-payment systems have evolved, and have become an apparently permanent factor in our modern credit machinery. Inevitably banking operation has expanded with the field which it serves, into a vast and complex business undreamed of in the philosophy of Adam Smith. No commercial banking system of importance in the world today limits itself, in point of actual fact, simply to financing the movement of

goods from producers to consumers. Thus, although this familiar formula for the proper functioning of commercial banking has remained practically unchanged for many years, today in actual fact it clashes with the daily practice of all our major modern banking institutions, including even that of our Federal Reserve banks themselves.

I have mentioned the important part played in American commercial banking by the security collateral loan, which enables a shifting of investments between dealers and investors. It seems altogether probable in the future that this accommodation extended by our commercial banking system to the processes of investment should continue to increase in both size and importance. Millions of Americans have, in the last decade, become persuaded of the value of thrift, and our modern American standards of living are in the main sufficiently high to permit wage earners of almost all types to save and invest in securities directly or indirectly. This means that the investment turnover of this country should increase even faster than its commercial turnover; it serves in a measure to explain the prominence recently assumed by the security collateral loan in our present financial system. Whatever theoretic and dogmatic banking economists may say or think of this matter, commercial banking in this country has very wisely and sensibly responded to the actual conditions before it by expanding its loans on securities, and it may be that this trend will continue to increase in the future, with beneficial results to banks, borrowers, and the entire general community. It is therefore high time that we undertook to revise somewhat our theory of the proper functions of commercial banking, and to expand it sufficiently to apply adequately to modern conditions. American banking should not, and indeed cannot be, shackled by the economic formulas of a century ago. The economic shibboleths of yesterday must be re-

vised to conform with the obvious business and financial realities of today.

VI

A final feature in the relationship between the Stock Exchange and American banking—perhaps the most fundamental and important of all, lies in the necessity of upholding and maintaining free and open markets in finance, and indeed throughout American business.

As never before, the direction of modern civilization is subject to essentially economic forces, and upon them we must all rely if our standards of living are continually to be bettered in the future. To no small degree, the problem of our modern day is a problem of marketing, and here there is a constant clash between the free and open market, and the closed and constantly manipulated market. In the modern stock exchanges, as in the similar organized markets for staple commodities, the aim is to create a market open for all to deal in under equal conditions, frank and complete publicity, and every collective safeguard that can be provided to insure a maintenance of the just and equitable principles of trade. Such markets are essentially democratic, since they take no hand in the making of prices, but simply establish price-making facilities which are available to the entire public of the country.

The maintenance of open markets of this type, it goes without saying, is a difficult task and is likely to continue to be, as long as self-interest plays so large a part in human nature. After all, the truth is not always an immediately popular thing, either in the marketplace or outside it. Any organization which undertakes to maintain a market which will impartially and impersonally reflect only genuine economic forces, must necessarily encounter continually selfish interests who wish to fix prices en-

tirely in their own behalf. Sometimes this element of selfishness is experienced on an almost national scale; whenever the organized markets report a drop in the quotations for cotton and grain—which America must sell, or a rise in coffee and sugar—which America must buy,—frequently agitation ensues to close the free markets. Indeed, open markets are continually challenged by the advocates of so-called “stabilization” schemes, at the root of which almost always lurks a desire to extend artificial benefits either to buyers or to sellers.

Someone, in a fine imaginative phrase, has referred to the “bloodless justice of the marketplace.” Here, so it seems to me, is expressed the true ideal for all financial markets to cleave to, through crisis and controversy. In the future even more than in the past, American business will need the impartial democratic marketplaces provided by the organized exchanges, and must resent any interference with them, either by ill-advised governmental action or the equally undesirable assumption of economic power by any private business group. Under freedom from either private domination or public control, the free and open market on the New York Stock Exchange has risen from obscurity to a central place in the financial system of the modern world, and for its further evolution along this very line it bespeaks the cooperation and understanding of the investment bankers of the nation.

MODERN BUSINESS AND GOVERNMENT

*Address at a joint luncheon of the National
Association of Commercial Organization
Secretaries and the Kansas City
Chamber of Commerce at Kansas
City, October 28, 1925*

MODERN BUSINESS AND GOVERNMENT

That this meeting of the representatives of commerce, manufacturing and finance should be held in the heart of the richest agricultural section of the world, seems to me a highly significant fact. For such a convention as this, representing as it does all parts of the United States and almost all types of modern American business, is a very hopeful sign as to the future prosperity of the country. It indicates quite clearly that the modern business man, no matter from what section of the nation he comes or what particular form of business enterprise he represents, thoroughly realizes the value of understanding the viewpoint of other sections of the country and of other lines of business. The day when any part of America or any form of American business was sufficient unto itself has long passed. In our business today, we are all affected by the prosperity or adversity of other people. In consequence, meetings of this kind should be, as the present one so obviously is, broadly representative of the whole country, if the business problems brought before it are to be adequately presented or discussed.

II

Not the least difficulty in the important work of promoting mutual understanding among American business men is the era of rapid and constant change in which we are living. Surely, the present is no time for the business man with a closed mind. As never before in human history, new scientific discoveries and new mechanical inventions are changing the whole basis of modern life year by year and even month by month. The impossibilities of yesterday rapidly become the conveniences of tomorrow. Upon

all varieties of American business, the steady impact of new scientific discoveries and inventions has been and continues to be tremendous, and business must in consequence continually take stock of itself, and further adapt itself to the radical changes so steadily being effected in our daily lives.

The true significance of modern scientific research and modern scientific achievements upon American standards of living and American business is striking when viewed in perspective. It is literally true that within our own life time, more profound changes have been brought about through the rise of scientific industrialism than all the preceding centuries of history had seen. Within the past thirty years, steel construction has spanned our widest rivers, has tunneled beneath our greatest cities, and has soared into the air in our innumerable skyscraper buildings. Electricity, originally a curious force exhibited in jars and coils in our scientific laboratories, has been harnessed to locomotion and transportation, to public and private lighting, to cooking and refrigeration, and many other now common-place uses in the homes of all of us. The gasoline motor, once merely a mechanical toy, has turned our modern cities inside out, has readjusted the marketing centers of the country, and has revolutionized the habits of living of almost all the inhabitants of this country. One might go on indefinitely enumerating, and in retrospect marveling at, the transformation of our daily lives during the past few decades which has resulted from this swiftly widening stream of scientific knowledge and its application to practical uses. Since it has wholly transformed the homes in which we live, the food which we eat, the clothes which we wear, and even the luxuries which we enjoy, it is little wonder that the effort of American business to adapt itself to these new conditions has been correspondingly strenuous and intense.

The great difficulty from the standpoint of the average American business man in endeavoring to forecast or estimate the future effects of scientific progress, even purely in his own line of work, arises from the fact that this age of science in which we are living has apparently only begun. Far from any tendency to slacken, the pace set by new scientific discoveries grows swifter year by year. Today we are living on the threshold of more momentous and far-reaching changes in the average man's method of living than ever before. Several momentous mechanical inventions, whose success and practical usefulness have already been thoroughly demonstrated loom as new factors of change in our entire business structure and even our whole social existence. After having been chained to the ground for thousands of years by the hitherto unconquerable force of gravity, air transportation has now become not a theory, but a reality, and shortly we will see it become an everyday convenience of business and recreation. This most radical departure from former methods of transportation in the history of the race, will necessarily require new legislation and new adaptations in our architecture, our methods of marketing, and the ordinary practices of almost every phase of American business. The tremendous prospect afforded by ready aerial transportation has in some respects already been paralleled by equally revolutionary advances in the science of communication. Wireless telegraphy, long another laboratory curiosity, has already become familiar to millions of American households through the swift emergence of the radio industry, and here also no one can yet see the limits of its intellectual or its commercial possibilities.

Today our chemists—less familiar but perhaps even more radical promoters of change throughout the field of American business—have revolutionized and set aside as obsolete, the old theory of separate

chemical elements or substances. They are actually realizing the dreams of the old alchemists by transmuting supposedly unchangeable elementary substances into each other, and where this will end no one can see. Chemistry is furthermore making by new synthetic methods, absolutely new and unknown substances which nature, for all her profuse creative energy, has never yet produced. Already the results of chemical research are yielding for our common use new metals, new textiles, new drugs, new food stuffs, and new materials of almost every description. All these new products are being rapidly commercialized and adapted to the daily life of the average American, and no American business man today can afford to conduct his business purely by rule of thumb, and remain blind to these far-reaching changes resulting from scientific discoveries.

One of the most familiar developments from recent chemical research has been the astonishing rise of the artificial silk, or rayon, industry. In only a few years, the making of rayon has grown from an obscure and purely theoretical experiment to an important position in the textile business of the world. For centuries previously, to obtain the strong, lustrous silk fibre, mankind was forced to cultivate the silk worm, and to patiently collect and spin the delicate fibres from his cocoons. But modern science has now created huge mechanical silk worms, into which vegetable fibre can be fed by the ton, and from which the new material, rayon, can be obtained in any quantity desired.

Such countless, rapid and dynamic changes in our ways of living, continually arising as a result of new scientific discoveries, constitute one of the most serious problems to the modern American business man, not only in respect to the relation of different industries with each other, but also to an important degree in respect to the relationship of all modern industry with the laws and principles

of our government. Old laws and old business methods must steadily give way to new, to adjust our political and our business methods to the constantly changing world in which we are living.

III

A second major problem to American business has been created because of the rapid growth and prosperity of business itself. Year by year during the past few decades, our domestic consumption of almost all kinds of commodities and produce has enormously expanded. The American standard of living has risen to heights never before reached by any people. A vast market for all kinds of merchandise has been created within our own country. What today is a luxury becomes a necessity tomorrow. There is no longer in the United States any actual struggle for existence—this has been superseded by a struggle for a standard of living. Americans no longer ask, as the original colonists did, whether they can survive at all. Today it is only a question of how well we can live.

This astonishingly well-distributed national prosperity is, of course, desirable from every standpoint, and none of us would have it otherwise. Yet certain difficulties to American business men have followed in its train. As time goes on, American business, in its continual expansion, tends necessarily to become more and more specialized. If we stop to think of it, most of us will find that we ourselves are steadily tending to specialize in some particular business, or in even a single phase of some one business, at the expense of a wider though more superficial grasp of business in general. In the future, this trend toward specialization will doubtless increase. The same thing is occurring in the professions also. Today we have few general medical practitioners left, while specialists in one or another

phase of modern medicine multiply by the thousands. The old-fashioned general store is likewise giving way to specialty shops. Even our banks are becoming more specialized, and the larger banking institutions of today are acquiring the habit of employing specialists in different industries to oversee the loans made to enterprises in particular fields.

There is little use complaining of this general tendency toward specialization or of fearing its consequences. Specialization now as in the past simply represents a more intelligent and more efficient division of labor. It is only a continuation into the age of science, of the tendency seen in even savage tribes for one man to be a hunter, another a fisherman, and a third a bow maker. But in the United States today, specialization has already been carried so far that each of us, because of our strenuous preoccupation with one particular pursuit, is almost compelled to lose sight of problems faced by other lines of business, and sometimes the general and less obvious problems which confront industry as a whole. In becoming a nation of specialists, American business men must see to it that they do not relinquish an intelligent and sound knowledge of the problems common to all American business enterprise, or a sympathetic and well-informed opinion upon types of industry superficially separate from their own. For in a democratic country like our nation, business for its own safety, cannot afford to become narrow minded, intolerant and over-specialized. In the long run, American business is dependent upon good government and good laws, both of which cannot be established and maintained except by public opinion. But public opinion after all is only what you and I and millions of other Americans like us believe. Just as you and I can and undoubtedly do have mistaken ideas, and sometimes persist in them for years, so too, public opinion in this country regarding business can be mistaken,

can be prejudiced, can be dangerously confused and misled for considerable periods of time.

In the future, therefore, it is going to be increasingly necessary for the individual business man in the United States to make an especial effort to understand not only his own problems, but also those of his fellows. We must none of us hastily make up our minds about activities in other departments of American business, until we are sure of the facts concerning them, and until we have thoroughly grasped the other man's difficulties. If American business is going to succeed in avoiding needless internal bickering and costly internal prejudices and misapprehensions, if it is going to maintain and enjoy a genuine policy of business cooperation on a national scale, we must all bend every effort to keep ourselves thoroughly informed regarding the main tendencies and principal problems of the major industries of the country.

IV

Still another factor of increasing importance to all lines of American business arises from the gradual conquest of the previously insuperable handicap of time and space, by modern methods of communication and transportation. In the last decade there has been a remarkable increase in the facilities for instant communication of information to and from all parts of the world, and the very speedy transportation of almost all types of merchandise and materials. For practical purposes, this has resulted in making the world a constantly smaller field for business enterprise, introducing new competitive elements into business, and in developing new centers of production and consumption. Today we all know much more quickly and completely what is going on in other parts of the world than ever before, and all business in this country has gradually become

sensitive to foreign economic forces hitherto considered too remote to be of genuine importance.

Even in this marvelously rich and successful agricultural section, the news from abroad has become of vital importance. To the Western farmer it is essential to know whether there is a drought or rain in South America, or in Europe. So in the naturally sensitive security markets of Wall Street, it makes a great deal of difference whether or not the monsoon in India is favorable to the crops of that country, and whether or not gold must be shipped thither from London, in payment for heavy Indian exports. Thousands of American housewives today are taking a keen interest in the coffee valorization policies of Brazil, the effects of which they see so clearly reflected in the price of the coffee they buy at the corner grocery store. Copper miners in Michigan are likewise watching very closely the sudden development of the new and apparently very rich Katanga copper mines in the heart of Africa, and the construction of the railroad which is to bring these ores into the markets of Europe.

Whether we like it or not, American business is going to be more and more influenced by such international situations and forces as these in the years to come. Nor can new legislation in this country ever succeed in wholly nullifying their importance to the American business man. American commercial, agricultural, financial and manufacturing enterprises have taken the world for their province, and their outlook must be as broad as the whole international field in which this country has become so important a factor. Particularly in the financial center in New York, the effect of international forces on American business has for a long time been manifest. Ever since the Armistice, we have been complacently telling each other that the United States has become the greatest creditor nation in the world. But most of us, I fear, have not even yet

given sufficient thought or attention to just what this now familiar phrase really signifies, or what adjustments in our way of doing business are foreshadowed. But before long we are going to find these things out. Just as a competent banker must study the condition of his borrowers, so American business as well as our government must give increasing attention to economic and business conditions in the main foreign countries where so many billions in American loans and goods have gone during the past ten years.

A very complicated form of interdependence has become a definite condition under which all modern American business enterprise must labor. We are none of us sufficient unto ourselves. You will remember that Mark Twain once said that there was no such thing as freedom—that even the tramp always had to watch out for the sheriff. So it is too with modern business in this country—our individual prosperity is and must continue to be dependent on the prosperity of everyone else. It may seem a far cry from the financial canyons of Wall Street to the wheat farms of Kansas. Yet the great crisis in wheat farming that occurred out in this section of the country a few years ago helped to bring about very quickly the most serious financial depression in Wall Street since 1914. On the other hand, the general agricultural prosperity of 1924 has very quickly made itself manifest in the New York financial markets. Certainly thousands of investors in the securities of automobile, mail order, steel, and agricultural equipment companies are today praying almost as earnestly as the Western farmers themselves that the crops of 1925 will prove even more profitable to the nation's farmers. The East cannot enjoy any sound or stable business prosperity unless the West also shares in it, while the West cannot prosper at a time when depression reigns in the East.

A clear realization of this fact is rapidly removing

the sectional feeling that to some extent has always existed in all forms of American business enterprise. If the last ten years has taught us any lesson at all, it has been that no one can permanently profit at someone else's expense, that prosperity in one part of the land will be quickly communicated to other sections, and that depression in one place will tend to spread in every direction very speedily. What we must all strive for is a better and more complete understanding of the factors necessary to national prosperity. Wall Street, naturally pre-occupied with purely financial questions, must nevertheless be able to look on agriculture and manufacturing from the standpoint of the farmer and the manufacturer. The merchants, although naturally giving the most of their attention to their own indispensable pursuits, must nevertheless exert themselves to see that the financial markets of America are kept free and open, and that the nation's currency remains untainted by the ever vicious evil of inflation.

V

The final leading problem of modern business—and in some ways the most important of all—consists in its relationship to the American government. If we business men find it so difficult to understand each other, to work out our common problems in harmony and with foresight, and sometimes even to agree with each other at all, it is naturally still more difficult for government officials, vested with the duty of protecting the public interest, but frequently without any considerable business experience of their own, to comprehend the needs and the problems of American commerce, agriculture, manufacturing and finance. Yet national prosperity depends not only upon establishing concord between the different classes of business enterprise, but also

upon harmonizing and stabilizing the relationship of all these with the machinery, the laws and the guiding principles of our federal and state governments alike.

Originally, before American business had grown to its present size or complexity, our government for the most part ignored business and let it go its own way, with little or no restriction. On the whole this was probably the best thing which could have happened at that time. Under what the British statesman and philosopher, Edmund Burke, once called "salutary neglect," business expanded and prospered under the free play of individual initiative. Our vast Western territories were opened up and colonized, our principal transportation routes were established, and business was able in a very effectual way to assist the federal government in unifying our huge national territory.

By the close of the nineteenth century, however, the attitude of our government toward business experienced a considerable change. It was an era of the new industrialism—an era of consolidation and merger. Through the absorption of smaller concerns, large industrial corporations, commonly known as "trusts," were suddenly created. Never before in history had such an industrial problem arisen, and it was entirely natural that the public became alarmed at what appeared to be threatened monopolies in business. At first, no one could tell where this movement would end, or what economic or social consequences would flow from it. The new organization of big business inevitably introduced evils as well as benefits in the business field. Some of our wisest statesmen came to believe that this sudden creation of the large unit in business directly threatened democratic government in this country. The whole so-called "trust" question became a serious public problem. Accordingly, a tendency developed to call upon our government to

regulate all business in the country which seemed in any way to possess a monopoly character. The government was greatly puzzled by this demand and at first did little or nothing about the matter, and then suddenly attempted to do entirely too much. More and more as time went on, the government began to interfere in business affairs, to regulate them artificially and arbitrarily, and in some cases to throw them into confusion by its cumbrous and bureaucratic methods. The danger that a plutocracy would develop in this country was superseded by the equally undesirable danger of a bureaucracy. This tendency toward increasing government regulation of business reached its climax and its practical test during the recent war period, when the federal government was forced temporarily to assume the supervision of practically all types of American business. This step was under the circumstances of war inevitable. But it afforded the public conclusive evidence and proof as to the dangers and inefficiency of any extreme form of governmental control over business, and of the basic necessity of that individual initiative in business affairs which has built up this country and has been mainly responsible for its size and prosperity today.

Today we are all much wiser than we used to be in regard to this matter of governmental supervision of business. We have been forced to realize by our costly and anxious experiment during the war that severe government regulation is no panacea for business problems. The parlor socialists recently listened to so generally, can scarcely obtain an audience today. But, on the other hand, the American public is equally aware of the fact that the day of absolutely uncontrolled business enterprise has gone forever, especially of course in enterprises which genuinely possess a monopoly character. Today we almost all of us believe that while government regulation over monopoly enterprises is here

to stay, it must be conducted by business principles rather than by speeches or political expediency. The government itself is perfectly aware that as far as the public interest is concerned, over-regulation of business is just as dangerous as the lack of any such regulation. We are thus entering an era of compromise between two unwise extremes when common sense rather than mere theory will be depended upon to solve the problems. Not the least factor making for business prosperity today, and for a higher standard of living throughout this country, is this more experienced and stabilized relationship between the American government and American business large and small.

VI

The relationship of business and government is, however, a two-sided affair. In considering the attitude of government to modern business, we must not forget the reciprocal duties which business owes to the government. There is just as great a need of public understanding on this as on the former score today. The business man of this country cannot afford to assume toward his government the attitude of criticism and aloofness which the period of over-regulation has developed. Neither can business approach the government with empty hands, asking favors but offering nothing. Since the War, I am glad to say, the average American business man has grown much less selfish and parochial than he used to be with regard to his demands for new legislation. There is still, however, plenty of room for improvement along this very line among American business men. We must more and more approach the aspect of modern business problems from a national standpoint, and seek not so much any particular or exclusive benefit, but the prosperity of the entire country as a whole.

It is a truism that a democratic government derives its power from the consent of the governed, yet this consent should not be merely passive and inert, but rather a living and vigorous thing. The sincere and unselfish cooperation of business with the government is completely essential to any real solution of the major business problems which are facing us all. Yet most of us, I think, will experience a twinge of conscience when we ask ourselves how much we have exerted ourselves to improve the efficiency or heighten the wisdom of governmental legislation impersonally and unselfishly. Most of us will admit, I think, that frequently we pay little or no attention to the men who are nominated for public office in this country, that often we fail even to go to the polls and exercise our power to vote. Government officials complain, and not without justice, that business men are only too apt to shirk their duties as citizens, and then complain bitterly about the need of business methods and business experience in governmental process. Most of us will agree that our national scandal of tax law enforcement is due not only to governmental inefficiency, but also to a lack of cooperation with the government by business men generally.

Those of us who happen to be engaged in the security business, and who have been in recent years deeply concerned with the serious problem of security swindling in this country, have come to the conclusion that this serious problem of security frauds can only be solved by the universal and hearty cooperation of our federal and state governments on the one hand, and the major business organizations and associations of the country on the other. In a campaign against security frauds, which in recent years the New York Stock Exchange has undertaken, this policy has been followed, and already promising results are flowing from it. There has everywhere been manifest on the part of

government officials, both in Washington and in the State capitols, a hearty willingness to cooperate in all ways with the business men of the country to rid the United States of the fake promoter and the salesmen of fraudulent stocks and bonds. It is now up to the American business man to join in this fight and perform his part and his duty in it. My principal purpose in coming here to address you today has been, in fact, to evoke the support and assistance of the commercial organizations of this country in this very matter. In the New York Stock Exchange we have set up a bureau to which, without any charge whatsoever, all complaints from the public regarding specific cases of security swindling can be sent. The function of this bureau is to call these cases to the attention of the appropriate government officials, and to exert every possible effort to obtain the active prosecution of all offenders. In this security swindling problem, as in so many of the other grave business problems of the country today, what is needed are a few good laws actively enforced, rather than a vast complexity of laws which are enforced only slowly and occasionally. But it is thoroughly inconsistent of us to complain one moment regarding the inefficiency of governmental control over business, and the next minute to expect our government officials to carry on this fight against financial frauds entirely single-handed.

Despite the sensational predictions of the prophets of radicalism, we are all living in a political democracy, and we will continue to do so in the future. The efforts of our hands and brains expressed in business affairs, must continue to be dependent upon the laws of the land, wise or unwise, and conditioned by the degree of public understanding as to our national business problems. There will always be the problem of the proper governmental attitude in this country toward business, particularly since we are living in a world which scientific progress and

the increased forces of foreign economic conditions are continually changing. That wise regulatory measures in respect to American business should be taken by our government, is no more essential to our national prosperity than that business men perform their full duties as citizens of this country, and approach the public aspects of business affairs in a spirit of whole-hearted cooperation and underlying patriotism.

STOCK MARKET LOANS

*Address before The Bankers Club of
Cincinnati, Cincinnati, Ohio,
April 7, 1927*

STOCK MARKET LOANS

I particularly appreciate this opportunity of addressing the bankers of this great and prosperous section of the country because of the constant and important relationship which banking here bears to the work of marketing and distributing securities on the New York Stock Exchange. In consequence, although this is my first visit to Cincinnati, I cannot help feeling that we have long known each other indirectly and, as it were, by proxy through our past financial relationships. Due largely to the New York Stock Exchange, a highly organized and standard market for call-loans on security collateral has been created in New York. This market has provided for the balances which every bank regularly or occasionally has, a profitable, safe and liquid method of short-term investment. Moreover the funds gathered and sent into this call-loan market through banks all over the United States, and especially banks in the Middle West, enable the work of floating and distributing security issues to be conducted smoothly and efficiently. It is therefore concerning this common bond which we both have in the call-loan market on security collateral that I would speak tonight.

II

As a bank director in New York, I have sometimes been asked, "What is a bank for?" No doubt bankers in Ohio also occasionally are asked the same thing. Foolish as such a question may at first seem, it is today not so easy to answer as it was fifty or one hundred years ago. In fact I venture to assert that, as banking in this country grows more and more complex, it is more and more diffi-

cult clearly to define the actual purposes and economic functions of our commercial banks. The classical theory of banking, of course, is to the effect that the banker finances goods in transit and merely business turnover. A century ago, when practically the only borrowers at the banks were merchants, this definition of the functions of commercial banking was undoubtedly adequate. In our own times also, we must all recognize how essential it is to the progress and prosperity of the country to have just such credit facilities to aid in the steady flow of goods from producer to consumer.

But as practical bankers, we must all freely admit that today American commercial banking is not in point of fact confined to any such limited formula. If any commercial banker is inclined to think this remark an exaggeration, I can only ask him to look at his own portfolio and in his own vaults. More and more as time has gone on, our American banks have assumed a general function of building up this new country of ours, and maintaining as far as possible prosperous conditions in the shop and on the farm alike. This extensive function of modern commercial banking thus includes lending such assistance as is possible, not only to the merchant striving to pass goods from producer to consumer, but also to the producer in his constant efforts to obtain better facilities for production, and to the consumer in acquiring sufficient means to be able to afford to consume. As a result, there is today some confusion of thought in regard to the function of commercial banking, and in general the tendency of the times seems to be more and more drawing us away from the classical theory of banking enunciated during the nineteenth century. But even if American banking today seems to be genuinely in need of a new economic philosophy and a new formula of functions, I have no intention of endeavoring to supply either of these needs here tonight.

I merely wish to point out certain frequently forgotten aspects of the call-loan market on security collateral, not only as respects its conveniences to borrowers and lenders alike, but also the economic function which is performed by placing funds there.

III

I imagine that the banker of the Middle West, like other bankers in this country, is led to sending on his funds to the call-loan market in New York today largely through custom and tradition. Before the establishment of the Federal Reserve System which has served the nation so staunchly and so brilliantly in both peace and war, the call-loan market on security collateral in New York where stock market loans were made, constituted the only unified reserve fund which American banks possessed. Although experience many times demonstrated to us that this former system was neither adequate nor scientific, at the same time the call-loan market became highly developed because of the unusual burdens which were thus imposed upon it. Indeed, I can state without fear of contradiction that no country in the world has ever developed so highly organized and efficient a market for demand loans on Stock Exchange collateral.

But the present as well as past popularity among American bankers of this call-loan market cannot be attributed merely to custom and tradition. It has provided and still provides certain very definite and important services to American bankers in the practical performance of their daily work. Indeed, had not this been the case, the custom for the bankers of the nation to invest their short-term funds in stock market loans could never have developed.

Without attempting any elaborate analysis of security market loans, I would point out the splendid

record which they have established for actual safety. This is not a matter of mere chance, but the result of a long evolution over many years. When loans are made in New York today to a stockbroker, the collateral for this purpose is very expertly selected, diversified and even priced. During the life of the call-loan, the lender has in his physical possession, and always ready for actual sale, the certificates which are pledged for the loan. The lender likewise has at his elbow the stock ticker which records minute by minute the latest security prices being made on the Stock Exchange, and he is thus enabled to protect his loan by demanding an additional margin of securities, or the substitution of strong for weak securities, or in extreme cases the complete retirement of the whole loan. As a class, call-loans on the collateral of Stock Exchange securities have proved over many years second to no form of short-term investment, in their actual safety.

In the second place, stock market loans as they are today made in New York, possess the very important quality of liquidity. Either lender or borrower can terminate any loan at any time. While some funds are continually entering the market, other funds are continually being withdrawn from it. There is thus created a liquid reservoir of credit, backed and amply margined with collateral which is mainly salable on the New York Stock Exchange in case of need. The degree of flexibility which the call-loan market has in the past lent to the American security business and to American banking goes without saying.

Some financial students have occasionally taken the position that the liquidity of our call-loans was illusory, since they could not all be liquidated at once. As proof of this undoubted fact, they cite the autumn of 1914 when the Stock Exchange was closed as a result of the war, and when in conse-

quence demand loans previously made on Stock Exchange collateral were mainly if not entirely frozen for the time being. Such an argument is, however, fundamentally both fallacious and unreasonable. Any practical banker knows perfectly well that no large class of bank loans, however sound or liquid, can actually be entirely liquidated at once. Even in the London bill market, which has been so justly admired by American as well as British bankers, the outbreak of the war in 1914 compelled the British Treasury to extend an endorsement and guarantee of the government itself to acceptances and bills of exchange in the London market, to prevent either illiquidity or utter collapse. The same general principle is applicable throughout any class of banks which have demand deposits. I scarcely need to remind you that it would be utterly impossible for all the sound commercial banks of the country to pay off all their demand deposits in gold at any one time. Yet, merely because of that fact, we do not condemn our bank deposits as illiquid.

In discussing the liquidity of short-term bank investments, we cannot measure it by any such standard as this. Only twice in its long history has the New York Stock Exchange been compelled to suspend for any important length of time. The first of these occasions occurred in 1873, when the great panic of that year, and the critically unsound condition of our national currency, brought on a closing of the Exchange for a period of ten days. The second and more serious instance was the closing of the Exchange at the end of July, 1914 for a period of about four months—a result of the previous closing of all the other important stock exchanges of the world, combined with the enormous amounts of American securities then held in Europe. Without risking dangerous prophecies, it seems unlikely that any such suspension of the Stock Exchange will occur in the future—at least

from any such causes as these. We apparently have little to fear on the score of currency panics, now that the Federal Reserve System has so firmly established a flexible gold currency. Moreover, America is today a creditor nation, and the outbreak even of a great foreign war should not compel the suspension of the New York Stock Exchange, however severely certain foreign securities listed upon it might decline; fortunately for us, the day when our principal organized security market had constantly hanging over it billions of dollars of American securities held abroad and likely to be pressed for sale in New York in the event of foreign disturbances, seems now permanently past. If this view of the matter is well-founded, lenders in this country on Stock Exchange collateral need have little fear that call-loans are not really liquid because the Stock Exchange might at any time be forced to suspend its operations.

IV

Many American bankers, though thoroughly persuaded of the safety and liquidity of stock market loans in practice, have paid little attention to the real functional and economic use to which the funds invested there are actually put. One sometimes hears stock market loans spoken of as though their purpose was to finance a meaningless process of mere speculation in securities, and to enable irresponsible people to engage in that interesting though hazardous pursuit. The frequently hectic and exaggerated accounts of stock market transactions only tend to deepen and confirm such an impression of the use to which the funds represented by stock market loans are actually put. Were this indeed the truth, such lending would represent a tying-up of valuable credits in wasteful and perhaps harmful activity, and on this basis it could not be justified,

however safe or liquid contributions to such a loan fund might prove in individual cases.

Actually, however, the pool of liquid bank credit which is represented in New York by the call-loan market on Stock Exchange securities serves not only a very useful but even an indispensable economic purpose in American business and finance. It has its counterpart in every other large-scale money market in the world, although undoubtedly the technique of handling it has been more highly organized in New York than anywhere else. The fundamental use of this aggregate amount of bank credit loaned on demand against security collateral is to enable the merchandising and distribution of securities from issuer to investor.

There is of course nothing peculiar or extraordinary in the fact that the distribution of securities requires the use of credit, just as does the distribution of any other form of merchandise as it passes from producer to consumer. In your capacity as commercial bankers, you are of course all perfectly familiar with the use of credit as respects mercantile distribution. Were it not for the funds which your institutions collect from depositors and make available in the form of loans to the mercantile community, it would be impossible to finance the wholesaler who buys goods from the manufacturer and holds them until he can sell them again to the retailer, or to finance the retailer while he keeps a stock on his shelves in the process of distributing it to actual consumers. The whole flow of merchandise from producer to consumer, in fact, depends directly on the use of credit to finance such intermediary operations, and without such commercial loans from the banks, our trade and commerce would speedily collapse. This is no idle theory. We have seen periods of stringent credit in this country when the process of financing the distribution of merchandise was forced to slow up and even

to suspend. We have only to read what has happened since the Armistice in Soviet Russia to realize that any serious impairment of loans from banks to merchants, not only spreads ruin throughout trade and commerce, but even deprives many people of the very necessities of life.

I have said that securities were merchandized and distributed in much the same way, and by much the same means, as other forms of property. Indeed, this becomes all the more apparent when one considers in detail just how new security issues are actually sold and distributed to the investing public. The financial syndicates that underwrite and issue new securities are fundamentally in the same position as wholesale merchants, who buy large quantities of goods not to use themselves but to sell to someone else at a higher price if possible, and on their own responsibility and risk. Such security syndicates of course are accustomed to make allotments of the new issue among participating firms of all kinds throughout the country. Such participants in the issue are like local commercial wholesalers or jobbers, who also buy not to hold but to resell as dealers. This fact is sometimes obscured by the statement printed in the newspaper advertisement of new security issues, to the effect that "all this issue having been sold, this advertisement appears as a matter of record only." It is the original syndicate that makes this statement, when it has succeeded in placing all the issue with private investors or participating firms of dealers. But owing to the fact that these local dealers have not necessarily sold their holdings to permanent investors, the statement is apt to create a certain amount of misunderstanding. It implies that the markets have been entirely cleared of the issue in question, when as a matter of fact there may be large amounts of it in the hands of the smaller dealers awaiting sale.

More and more, of course, there is a tendency throughout American business for the consumer to buy directly from the producer, and this has its parallel in the security business when private permanent investors take up any offered issues directly. Nevertheless the experienced investor is apt to be, and quite rightly, somewhat wary and skeptical of securities that are absolutely new. Very naturally, he prefers seasoned securities that have been under fire and proved their substance and merit. Accordingly, only the most gilt-edged securities as a rule can be sold directly by financial houses of issue to permanent investors. As a result, in almost all new security issues there is bound to be a "floating supply," which represents that portion of the issue for which an investment demand has not yet developed, and which must in consequence be carried by dealers of one sort or another in much the same way that other merchants carry on their shelves goods which consumers have for the time being been unwilling to purchase. Such dealers operate in a very similar fashion to the commercial merchant, in that they carry their unsold goods by means of bank loans. In the particular instance of security dealers, however, the actual securities to carry which these loans are contracted, are put in an envelope as collateral and placed at the direct disposal of the lending institution. This is naturally a great advantage to the lender, and if the security collateral is sound, it makes this class of loan particularly safe to him.

But the "floating supply" of securities does not have to be carried entirely by professional security firms. Were this actually the case, our whole financial structure would be perpetually burdened and hampered with unsold issues, and its power to finance new business undertakings would be vastly reduced. Such a situation is avoided by the free and open market for securities created by the New York Stock

Exchange. When a new security is listed on the Exchange, a new class of dealers is made at once available for its distribution. These new dealers are of course the private security traders and speculators of the country, who in security distribution fill much the same function as a retail storekeeper in purely commercial transactions, although they themselves almost never realize this fact. These private dealers who buy through Stock Exchange brokers on credit, and who gradually take over the important function of carrying the "floating supply" of securities on the market, are also forced to employ credit. Naturally the broker cannot furnish all this credit from his own resources, as this is plainly not his real function. Accordingly, the stockbroker carries his customers' securities to banks and other lending institutions, and obtains the loans whereby they are carried through using them as collateral. This is the basis of the extensive market in New York for security collateral loans, and the securities held there in collateral envelopes by lenders might be described as a tremendous department store of investments awaiting sale to the permanent investors of the country.

With securities of genuine merit, the tendency is for them gradually to be bought up by outright holders and investors, and gradually to disappear from the loan envelopes in New York, where they so largely reside until they can be permanently sold in this way. After old issues disappear from the markets, new and untried issues appear to take their place.

Little attention has been paid by financial students to this very fundamental and very important process, partly I imagine because it is so difficult to obtain any reliable statistics concerning it, and because the whole process occurs on so large a scale that it is difficult definitely to gauge or measure. There are, however, a few straws available to show

how the wind blows. One such indication is to be found in the very interesting figures published each quarter by the United States Steel Corporation as to the percentage of United States Steel stocks held in the names of brokers, and in the names of private individuals. In a general way, of course, stock standing in brokers' names represents the "floating supply" which is being carried mainly in collateral loans in Wall Street, while stock in individual names represents the outright or investment holdings of individuals all over the country. At the beginning of 1910, about two-thirds of United States Steel common stock stood in the name of brokers, and in a rough way it is fair to say that only about one-third of the issue had actually been sold to permanent investors. This proportion varied more or less from one quarter to another, but the tendency was plainly for the brokers' holdings to fall and the investors' holdings to rise, as the actual investment distribution of the shares proceeded on the New York Stock Exchange. By the beginning of 1916, just about one-half of the issue remained undistributed. By the first quarter of 1920, two-thirds had been distributed, and only about one-third remained in the "floating supply." Recently this proportion has been still further reduced, so that now only from one-fifth to one-fourth of the issue apparently remains undistributed to investors. Because such changes in the distribution of shares usually occur over considerable periods of time, they are apt to be disregarded. But after all, it is this gradual distribution of securities which allows them to become seasoned, which allows investors to invest conservatively, and to resell at need. The distribution of securities effected in the first instance by security syndicates is of course highly necessary and important to the ultimate placement of the issue among outright holders. But it is, after all, only a preliminary step, and it remains for the New York

Stock Exchange, through the facilities it provides for security distribution, to effect over many years the permanent distribution, and ultimately to reduce the "floating supply" of it on the market. This gradual process of distribution which occurs through the facilities established by the New York Stock Exchange would of course be completely impossible of performance unless there was available for its use considerable amounts of credit regularly engaged in stock market loans.

V

In the past an additional question concerning stock market loans has frequently been asked—whether or not they are too large. This question, indeed, used to occasion considerable excitement when the actual amounts of money loaned on security collateral to finance security distribution were still unknown. In order to end this needless mystery and to make available exact information on the subject to all students of American finance, the Stock Exchange about a year ago collected and published the aggregate amounts of security collateral loans obtained by its members as borrowers, as of the first of each month. Simultaneously, the Federal Reserve Bank of New York adopted the policy of publishing the similar aggregates for security collateral loans made by its members, on a weekly basis. At the present time, therefore, total figures for this important department of American banking are being issued both from borrowers and lenders.

When these stock market loan statistics were first issued, they occasioned some comment because they were running slightly in excess of \$3,500,000,000. There was for the time being a tendency to think that this was a rather large sum of money—as undoubtedly it is. When, however, the stock market loan figures were considered in proportion to other

and related financial figures, this sort of criticism rapidly disappeared. I have pointed out that primarily security collateral loans are employed to finance the floating or undistributed supply of securities in the market. On January 1, 1927, total borrowings of New York Stock Exchange members on collateral in New York amounted to \$3,292,860,255. At the same date the actual market value of all the stocks and bonds listed on the New York Stock Exchange amounted to \$75,543,769,606. In consequence stock market loans amounted to only 4.35% of the total value of New York Stock Exchange listed securities. Actually, even this proportion is unduly high, when it is remembered that security collateral loans are employed to finance the distribution of many issues not listed on the New York Stock Exchange, such as newly syndicated securities and New York Curb Market listed issues.

It is furthermore a fact that while the market value of New York Stock Exchange listings as a whole rose from slightly less than \$70,000,000,000, on January 1, 1926 to over \$75,000,000,000 on January 1, 1927, borrowings of New York Stock Exchange members have not only shown no increase over the same period, but have actually decreased several hundred millions of dollars. This fact has been attributed to the constant tendency for investors to buy up and hold for investment securities previously held in the market "floating supply," and is a very genuine indication of the tremendous rate at which security investing is increasing in this country.

I scarcely need argue the point before this convention of practical bankers, that in future years the tendency may well be for our stock market loans to increase as the wealth and development of the country expands. Whether stock market loans are too great or too small is a difficult subject upon which to generalize, since accurate data has been available for so short a time. In any case, stock

market loans at any figure are not necessarily too great or too small, but only in proportion to total outstanding security values and other such related figures.

VI

A final question concerning stock market loans might still be asked. Even though we grant that they are an indispensable facility to the distribution of securities by syndicating houses, and on the great organized security market on the New York Stock Exchange, one might still inquire what ultimate good all this work of security distribution actually performs for the average citizen of the United States today. Although the answer to this question is sufficiently simple, nevertheless it involves the whole panorama of the economic development of the United States. For fully a century, the rapid advances made in steam transportation, in speedy communication, in wholesale manufacture, and in many lines of commercial distribution, have necessitated larger and larger amounts of permanent capital, and steadily larger corporate units in business. The past hundred years has seen the physical facilities of daily life brought up from a stage where they were little superior to conditions in ancient Rome under the Caesars, to our modern times where amazing and far-reaching discoveries of scientists and inventors have been placed wholesale at the services of the individual. There is little argument over the assertion that today, economic conditions permit a larger number of people to live with the highest standard of living ever seen throughout history, and that one by one the great bulwarks which in the past have hampered and confined the life of man have been and are being thrown down forever.

Scarcely a month passes without its triumphant announcement of additional discoveries and additional facilities. We have just familiarized ourselves

with the truly astonishing service placed in practical operation by our telephone companies, whereby we may pick up the receiver at our home or office and talk with any friend or business acquaintance in England, far across the Atlantic Ocean. Thus far at least, there seems to be no necessary limit to the discoveries of science and the improvement of the facilities and conveniences of daily life for the future citizens of this country. All this, I say again, has been made possible by the steady flood of corporate financing which started a century ago in Wall Street as a very small scale and uncertain business, but has since increased to vast proportions as its value, and indeed its necessity, to us all have been so strikingly demonstrated. And this steady distribution of security issues, which has on the one hand placed the conveniences of modern life at our disposal, and on the other created the great investing public of this country, has in turn depended on the liquid pool of credit in the security marketing centers represented by stock market loans.

I make no claim that this department of banking is any perfect system. It has the same fallibility as any other creation of the human mind and of human effort, and no doubt this will always be true. Yet judged by the economic results of its operations, it is indeed a good thing. Those who have loaned their funds to assist the purposes for which stock market loans are created, have made a distinct contribution to advancing the development of the nation. Those who have borrowed these funds to assist in the smooth and steady distribution of securities, have themselves been performing an indispensable economic and financial service for us all. If this country is to realize the high hopes which we all entertain for its future, no impediment must be placed in the way of this great work. It is for us who from our daily tasks are enabled to understand these economic and financial operations which

have built up this country, to see to it that the financing of the stock market is in the future continued without undesirable exaggeration or unwise restriction, that the fruits of discovery and invention may continue to be placed broadly and steadily at the service of all mankind.

FRONTIERS OF AMERICAN FINANCE

*Address before the Members Forum Meeting
of the Portland Chamber of Commerce,
Portland, Oregon, November 8, 1926*

FRONTIERS OF AMERICAN FINANCE

It is naturally most interesting for Easterners to see with their own eyes the marvelous progress which has been made in building up this wonderful section of our country. But even more significant is the feeling we experience, of re-invigorating ourselves with the pioneer spirit which runs so strongly here in the Northwest and which has been so fundamentally responsible for making this country what it is today. I realize that it may seem somewhat peculiar for a New Yorker to come to this new metropolis of the Northwest to talk on the subject of pioneering to the descendants of the very men by whose efforts, and sometimes by whose lives, this section of the country was founded. I have little doubt that my stay in Portland, brief though it be, is liable to teach me very much more about this subject than I can hope to impart. Yet there is an aspect to the pioneering process which has achieved such remarkable results here in the far West, which is very frequently overlooked and forgotten, and in which I happen to have been long interested owing to my experience in the New York Stock Exchange. For not only has the American frontier always exerted a profound effect on the money and securities markets of New York, but the New York financial center has likewise been able to perform tremendously important financial assistance and co-operation in behalf of the continued conquest and settlement of this country.

II

While in many respects America is still a young country, nevertheless from another standpoint it is by no means a new one. We sometimes forget that our representative form of government, having enjoyed

almost a century and a half of continuous existence, is today one of the oldest unchanged forms of government in the world; this fact is all the more marked, of course, since the epochal changes produced throughout political Europe by the Great War. As a nation, therefore, we can no longer plead our youthful innocence and inexperience in governmental and other affairs. Indeed, our Atlantic coastal states have been settled for several hundred years—a sufficiently long period for the mode and habits of American life to have become in large measure stabilized and permanently established.

On the other hand, the United States has at no time lacked its frontiers, and great sections of our country are still very new indeed. Moreover, the constant pioneering in and through these newer sections of the land has left its indelible impress upon the whole nation. The long-continued westward thrust of our people across the great plains and over the Rocky Mountains to the Pacific coast has steadily rendered the American frontier a very vital factor in all our civilization and society, and a profound influence not merely in all our governmental and business affairs, but also in the very spirit of our people. In consequence it is especially necessary today, in the common interest of a better and more complete national understanding, and a more thoroughgoing cooperation between the sometimes far-removed sections of this vast country, that the East should acquaint itself in a thoroughly realistic way concerning the westward settlement, by the indispensable method of coming West and seeing its present-day results. It likewise follows that the West should fully appreciate the always keen, though of course less close and intimate, interest of the East in this vast pioneering triumph which you and your forefathers have wrought.

The story of the earliest pioneers in this Northwest country—especially, of course, the first daring

journey of Lewis and Clark through what was then an uncharted wilderness—is familiar to all Americans. It has the simplicity and the imaginative appeal of a great epic. Equally inspiring, though possibly less dramatic, is the more complicated second act in the drama of the Northwest, when the innumerable trappers, ranchers, homesteaders, miners and lumber men who slowly fought their way after Lewis and Clark into these boundless regions established forever the Northwestern boundary of this nation. Although mainly unsung and individually forgotten, these earliest pioneers and settlers blazed the trails for our magnificent modern arteries of travel and commerce to follow, and began the long task—not even yet concluded—of colonizing the virgin wilderness. The lack of any ready means of transportation or communication with the East rendered this continual westward urge of our forefathers a slow, uncertain and often perilous process. Mechanical invention had not yet succeeded in overcoming the vast distances of the North American continent. American finance had as yet no direct or practical connection with the gigantic initial problem which they faced, of settling the West. The financial centers of the Atlantic seaboard had, to be sure, already established themselves in a small way, but the scope of their operations was still confined to financing needs of our new Federal and State governments, and to collecting the capital needed to found the local eastern banks and insurance companies which our suddenly achieved national independence had rendered so imperatively necessary for the growth of American industry and American trade. To trace during these early years any close connection between our frontiers as they moved slowly westward, and the as yet undeveloped financial machinery of our eastern cities, would therefore at the time have seemed fanciful indeed. Yet even then there were not lacking

Americans with sufficient vision to foresee not only the fundamental need of such a connection, but also to forecast in theory, at least, the means by which it could be accomplished in coming years. In the early financial markets of New York or Boston or Philadelphia, there was in fact a spirit of enterprise and adventure abroad which was closely akin to the spirit of the western pioneers themselves. Already there were dreams of enormous canal systems which might serve to connect the East and the West. All manner of visionary and fanciful projects were in the air. Instinctively, eastern merchants were watching the American frontier, and pondering over the gigantic problem of settling the West. Yet for the time being no means was at hand whereby the money and securities markets in New York could lighten the tasks of the American settler as alone and unaided he faced the setting sun.

III

Locomotion by steam power was in the beginning an English invention, yet nowhere was it so demanded by national conditions as in this country, and nowhere was it taken up so enthusiastically and upon so gigantic a scale. The swift development of steam railroading provided the first genuine solution for the already old and hitherto insuperable problem of transportation and communication over our vast land area. Suddenly it was found that by means of the steam locomotive, the western frontier could be placed within easy access of our Atlantic coastal cities. Moreover, with the steam railroad developed as a means of American inland transportation, the eastern financial markets of this country could lend direct assistance in the task of settling the West.

While the pioneers in this north west territory were still striving to colonize the wilderness by methods

little better than those available to the colonists of the early Roman Empire, a net-work of steam railroads was speedily developed in the East. As a financial corollary to their construction, new and vigorous markets for railroad securities were also speedily developed in New York and other eastern financial centers; by means of these markets, the surplus funds of American investors were collected and poured into new railway construction. To builders and investors alike, the first American railroads proved a hazardous form of enterprise, yet so admirably did they solve the ever-present problem of overcoming the vast distances within the United States, that their construction was constantly pressed. On the New York Stock Exchange a financial machinery was at the same time developed to market railway stocks and bonds, and thus to raise the huge capital sums needed for this continual westward extension of new railway lines. In 1869 the Union Pacific was able by special assistance from the Federal government to cross the continent to the Pacific coast. Soon afterwards, however, private financing made possible remarkably swift construction of railway lines over the old pioneer trails through the Northwest and Southeast. Thus additional trunk lines to the Pacific were established and a practical partnership was effected between the financial machinery of the New York stock market, and the pioneers and settlers throughout this vast western territory.

The development of the modern railway in this country is by no means concluded today, although the great permanent arteries of our national inland commerce have been permanently established. There still remains, however, the task of improving the lines already laid down, and constructing spur trackage whereby previously isolated districts can be opened up and rendered accessible to the larger western and eastern centers of population. If I am not mistaken, there have been examples of this sort

of development very recently right here in Oregon. There is no necessity for me to argue the dependence on steam railways of our national trade and business prosperity. We all recognize our dependence on the American railway network, and its vital significance to the development of this country. It is with no careless use of metaphors that the late J. J. Hill was called an "empire builder" because of his conspicuous services in providing railway transportation here in the Northwest.

The construction of railroads in our western states has in fact for many years possessed a vast significance to the whole country, and it has meant different things to different parts of the country. In the West it has no doubt been viewed mainly from the standpoint of engineering development, accompanied by a realization of some of these difficult legislative problems which the establishment of railroads in this country necessarily brought in its train. In the New York financial center, railway construction in the West has for the most part been thought of from the standpoint of the many stock and bond issues by which capital was raised to do the work. In any real consideration of our modern railway problem, both these points of view must of course be taken into careful consideration. The investor in railway shares, no less than the railroad employee or the railroad shipper, is entitled to his day in court. All along the financial markets of Wall Street have lent an indispensable assistance to the development of the West by collecting from the American investing public the funds which were needed to lay railway track, purchase equipment, and establish the efficient transportation system of our own time. In any complete account of this remarkable growth throughout our western states—a growth which has no parallel in all history—or of the western pioneers and their triumph over the ever receding frontier, this great financial contribution

effected by the stock market in New York cannot be disregarded. Railway lines could be built only as fast as security buyers could be found to finance the process, and there has long been a direct and necessary relationship between the distribution of railway securities through the Wall Street markets to American investors, and the extension and improvement of our transportation arteries.

But the obligation of the West to the financial center in New York is by no means a one-sided affair. It has been fundamentally due to the tremendous scope and the conspicuous success of American railway construction, that the New York Stock Exchange has grown from inconspicuous beginnings to its present rank among the very greatest securities markets in the world. For many decades, the New York Stock Exchange was first and foremost a market for railway securities, and without its experience in this continual task of raising funds for railway construction and expansion, it could never have so successfully accomplished its subsequent task of raising vast capital sums for the up-building of American industry, or have handled with an equal facility its active and extensive business in other kinds of financing. The fact that railway financing through the public distribution of bonds and shares had for so many years been on such an extensive scale, led to the creation on the New York Stock Exchange of a free and open market for securities which has subsequently lent a vast assistance to all the larger branches of American industry as well.

IV

Even this superficial consideration of the forces which resulted in the building of our western railroads, and the swift development throughout our western states, leads me to say a good word for one of the most useful and yet one of the most unpopular

figures in modern American life—the speculative investor. It is easy to condemn the security speculator, to call him a mere gambler, and to attribute to him whatever current economic problem may happen at the time to be most pressing and difficult. But it is not easy to disregard what his funds have done in building up this country. There is little doubt that the growth of the United States in an economic way has so far depended fully as much on the security speculator, as on the security investor. Of necessity all business enterprises are risky at first, and the securities whereby they seek capital from the public are in the beginning necessarily speculative and uncertain. Such securities the genuine investor should not and as a rule will not purchase, and for their distribution the security speculator is an absolute necessity. The presence in this country of a numerous class of such security speculators has in a financial way been one of the leading factors in our constant and rapid progress. Especially has this been the case in the construction of our early railroad lines. It was after all the American speculator in securities who purchased the materials, paid the labor, hired the management, and bore the initial risk and burden of these epoch-making and hazardous adventures in settling the North American continent.

As a matter of fact, the speculator in railway securities has many things in common with such an apparently dissimilar figure as the early western pioneer. Both had a great faith in the future of the West. Both undertook tremendous personal risks, whether of life or possessions, to realize this future. Both were spurred on, not only by the common danger of failure, but also by the common desire for personal gain. Indeed, it is safe to say that to a considerable extent every pioneer has to be a speculator, and every speculator to some degree a pioneer. In the particular case of the settlement of the West,

the partnership struck between the enterprising western colonizer and the adventurous eastern capitalist was peculiarly effective and necessary. Without the steady vision, the hardy courage and the endless ingenuity of the western pioneers, there could have been no profitable opportunity for the investment of eastern speculative capital. On the other hand, without the financial support of eastern speculators in railway and other securities with sufficient belief in the future of this great western region to risk their savings in developing it, the efforts of the western settlers themselves would of necessity have proved a slow and terrible task, and might have taken centuries. What the western pioneer and the eastern purchaser of speculative securities have done together is now a matter of history—it constitutes a triumph over natural obstacles on a scale never elsewhere approached in the long annals of colonization and nation-building.

But the successful conquest of the western frontier is not simply a thrilling incident in our past history. It possesses important modern consequences to us all. The close connection between the development of the West and the prosperity of the East has been frequently misunderstood and misinterpreted. Nevertheless both the East and the West have benefited by the remarkable development of this part of the country, to the extent which each really participated in it. In the financial markets of New York, at least, there is little illusion concerning the fact that prosperity today is and must be nationwide, and that unless conditions in the West are favorable to it the East cannot enjoy prosperity. In the long run, no misinterpretation of this fact can long succeed in blinding any of us to the common national interest of American business today.

There is likewise a great governmental significance to the successful establishment of the Western railway lines and other facilities for travel and communica-

tion. The United States government could not possibly administer its business with success and dispatch over the vast land areas of this great nation—a larger territorial area than not only any republic but even any empire has ever successfully administered in history—without being very fundamentally indebted to the American pioneers who overcame the western frontier, and the eastern investors who risked their fortunes to aid them.

V

From an economic standpoint the establishment of the western railways proved but the first stage in the growth of this section of the country, although it was no doubt the most important step of all, since practically all subsequent efforts have depended upon it. In the path of the railway lines, great and vigorous cities have sprung up throughout the West—cities which, unlike so many new communities, have wanted at once all modern conveniences and improvements. There has in consequence been an immediate call for further vast sums of capital to establish water supplies, gas and electrical services, and the other utility enterprises upon which modern city life has come to depend. So effectual has proved the cooperation between western business men and American investors in the eastern financial markets, that the growth of the West has been a subject of astonishment not only to visitors from other countries but even from the eastern states themselves. I will even venture to assert that you yourselves are still too close to the astonishing progress which you have made here, to realize fully just how remarkable it has really been. Your country-side in the West is still wild and untamed, as nature left it. It lacks the appearance of age-old cultivation so familiar in the older countries of Europe, and only to a lesser extent in the older eastern states of this country.

And yet throughout this endless panorama of almost untouched natural resources, you have developed cities which today are challenging the older eastern centers in the facilities and comforts of city life. As a matter of fact, you have not been slow to avoid the mistakes frequently made in building up our eastern centers, while you have immediately seized upon the more desirable results of eastern experience.

It would undoubtedly be a huge piece of presumption for a New Yorker like myself to suddenly appear in your midst and give the appearance of laying claim to the credit for this remarkable transformation of the Northwest which you have wrought. Such, I assure you, is very far from my intention. Nevertheless I do not think you will take it amiss if, speaking in regard to the long-continued financial aspects of western progress observable in the New York securities market, I venture to remind you that without the services of the continuous supply of capital made available here by the distant financial center in New York, the growth of the West could never in so short a time have attained its present scope and magnitude. There are in fact many investors and financial houses in the East who are intensely proud of the share which they have had in financing the development of the West and who feel that their indispensable and yet frequently overlooked contributions in this mighty work have proved the most constructive achievement of their lives.

Much has been written of late concerning the passing of the old western frontier life. Although you may still have visitors here who come expecting to see the "wild west" of romance, instead of a rapidly progressing and intensely modern business community, I imagine that most Easterners today realize perfectly well that the Indian and cowboy are and have been for some time rapidly vanishing types here. Nevertheless in our periodical literature, and

our novels too, it seems to be conventional to lament the passing of the early and naturally primitive conditions in the West. I imagine that most of this melancholy regret for the past is expressed by people who themselves know little enough about the old frontier days from personal experience. Few Westerners, I dare say, would care to revert to the conditions of twenty-five or fifty years ago here, however delightful these conditions may be made to appear by modern novelists and scenario authors. But the really significant fact that has struck me during my stay here has been that the essential pioneer spirit of the West is not passing away at all, however much the form which this spirit takes may have changed. As former tasks are completed, new ones are continually arising to challenge your enterprise, your imagination, and your faith in the future of this part of the country. Indeed, the frontiers surrounding business enterprise and finance are perpetually renewed. As a matter of fact you have more pioneers here today than ever before, and the old spirit of the woodsman and trail-blazer is being kept very actively alive by the modern western business men of this section. The courage and willingness to assume the new risks continually entailed by progress has not ceased, even if today you are risking your bank balances where previously your grandfathers risked their lives.

Already you are encountering some of the problems with which the eastern states have been long struggling, and one of these is the wise investment of your surplus funds. With the continued development of this part of the country, it seems to me inevitable that your surplus of investable capital will greatly increase. In such a new section of the country, with its tremendous natural resources still so largely undeveloped, it is of course equally inevitable that most of your local savings will be invested in local business enterprises and undertakings near at hand.

Any other considerable disposition of your surplus funds would indeed be most unnatural and probably unwise. Nevertheless the ability of western investors to purchase securities in the New York stock market is already recognized there, and as time goes on it should steadily increase. Such at least has been the history of our eastern and middle western states, and although the time when your local business opportunities will fail to provide sufficiently attractive outlets to absorb most of your savings seems remote at the present time, I imagine that ultimately you will experience the same general evolution in matters of security investment as the states further east have done and are still doing.

VI

From one standpoint, the history of the United States might be described as a process under which old frontiers were constantly being changed for new. Today, the initial phases of settling the West have undoubtedly been concluded, although, considering the vast undeveloped resources here, the later stages of this same task should occupy several generations still. But more and more, as time goes on, you will be bound to invest your surplus capital to an increasing extent in other sections and even in foreign countries. The work of the pioneer and his struggle to overcome natural obstacles in cultivating new territories will still continue. But to an increasing extent the part which Americans will play in this process will be that of the investor and capitalist, and less and less that of the actual explorer and settler.

Even before the war the United States was probably the wealthiest nation in the world, and was furthermore the nation where wealth was being most rapidly created. But today, eight years after the Armistice, the United States has also become the

greatest creditor nation on earth. We have apparently reached the stage in our national economic development where the capital created each year by the work and thrift of our people is more than sufficient to satisfy the sound and immediate needs of home enterprises, great though these undoubtedly are and will continue to be. As a result, loans to foreign governments and foreign business enterprise have in the past ten years become a common phenomenon in the New York financial markets for the first time in our history.

This sudden change in our national status from a debtor to a creditor nation has come upon us so rapidly that we have not as yet developed the experience and the point of view which should accompany the international investment of our savings. Yet the real significance of this sudden change is that the frontiers of American finance have at last expanded even beyond our national borders, and that today the whole world has become our economic frontier. The same pioneer spirit, and the same judicious yet courageous use of our capital that characterized the conquest of the West, we must now endeavor to utilize on the even vaster international stage. For, after all, prosperity is in the long run international. It is true that the United States is less dependent on other countries in an economic way than any other modern nation. Nevertheless we can scarcely hope for a permanent national prosperity in a world impoverished and disrupted by the war, lacking in productive facilities, capable of only a greatly diminished rate of consumption. In consequence, the outward flow of American capital has in indirect but most important ways become very essential to us and our own prosperity. The present financial frontiers of this country are, as I have said, worldwide. Not only does the task of financing the rehabilitation of Europe confront our financial markets and our security investors, but also the

new continent of South America must seek here the capital needed for its further development.

The final feature of the foreign employment of American capital is no doubt of special interest to the progressive cities of our Pacific coast. I refer to the slow improvement in the standards of life, as they exist in the crowded and ancient countries of Asia. In the vast populations there, a tremendous potential purchasing and consuming power is inherent, and as far as this can be developed by American foreign investment, our Pacific coastal ports and cities which face towards the setting sun should especially benefit. Few serious students of the subject have ever doubted the tremendous coming importance of the Pacific Ocean in the future trade of the world, and new though your business centers may be here, they are inevitably due to become the outlets for American commercial participation in this trade. Perhaps I am ranging too far into the future; nevertheless it has seemed to me that some of the foreign financing effected in Wall Street during the past few years would some day come to be recognized as a very fundamental step in stimulating American trade to the Orient, and developing commerce through our Pacific coastal centers.

It is because such new economic tendencies as these manifest themselves early upon the New York Stock Exchange in one way or another, that I have ventured to call your attention to the present day international facilities which the Stock Exchange provides for foreign as well as domestic investment and speculation. The New York Stock Exchange has long served as a national securities market. As far as mechanical inventions have permitted, we have endeavored to place its facilities equally at the disposal of all sections of this country. Today here on the Pacific coast the stock ticker which reports transactions occurring on the floor of the New York Stock Exchange over three thousand miles away, is

on the average only about a minute behind the similar tickers in New York City. In other directions likewise we are continually striving to suit the methods and practices of our market in New York with varied needs and demands from all parts of this country.

Yet today the New York Stock Exchange has of necessity assumed an international significance as well. It provides the means whereby American funds can with vision, courage and understanding be sent abroad to carry on the vital work of maintaining American business prosperity and spreading it through other continents as well. In this new era of international financing, it is inevitable that financial speculation by America will perform its accustomed functions. But as a guiding influence in this movement, there is also required the pioneer spirit which has developed this country and which now must cope with the present-day world-wide frontiers of American finance. It is not enough that America has acquired sufficient capital to fill this new role as the greatest creditor nation of our time. There is also needed, as a directing force to our capital as it is sent to other countries, the characteristic abilities of the American pioneer spirit to dare, to dream, and to endure.

COOPERATION AGAINST SECURITY FRAUDS

*Address before the Seventh Annual Convention
of the National Association of Securities
Commissioners at Richmond, Va.,
September 17, 1924*

COOPERATION AGAINST SECURITY FRAUDS

Before beginning my address today, I want to say how much I have been impressed by the special Proclamation concerning the protection of investors, issued by the Governor of Virginia, the Hon. E. Lee Trinkle, in connection with your convention. The New York Stock Exchange has long been a staunch supporter of the efforts of the National Vigilance Committee and the Better Business Bureaus, upon whose important work Governor Trinkle has very rightly laid such stress. Accordingly, at the very outset of my remarks, I wish to place on record our hearty endorsement of Governor Trinkle's able plea for wider public education concerning investment matters, and for an intensified public and private effort to curb security frauds.

From the standpoint of the legitimate dealer in securities, a conference such as the present one, of State officials assembled from all parts of the country and vested with the responsible and highly important public duty of protecting the American investor against security frauds, is both gratifying and significant. It indicates that everywhere State officials realize very clearly that they are struggling with a nation-wide problem, and that therefore they must, through conferences of just this sort, combine their separate efforts through a process of complete cooperation on a national scale if they are to accomplish the utmost results in their work. It is, moreover, a sign of the times in which we are living that your association has taken the further step toward national cooperation in its important tasks, by inviting a closer contact with the private busi-

ness interests of the country who have also long endeavored to halt the security swindler on their own account.

Indeed, in practically every large-scale and long-established line of business in this country, there have developed two separate codes of regulatory principles whose basic purpose is the protection of the public. One is the external force of the law, the other the internal force of various trade practices and rules of conduct gradually evolved and enforced by business men themselves. The former code depends in the last analysis upon the political power of the public as citizens to insist upon the enactment and enforcement of public statutes beneficial to the processes of investment; the latter code similarly depends upon the economic power of the public as investors to direct its surplus funds into the channels where they are afforded the most honest and profitable treatment. This general situation, common to all business, is very strikingly present in the security business. But in the long run, both external laws passed concerning security transactions and the internal trade practices which evolve from practical business operations, have a common object and depend for their continuance upon a common performance—the protection of the investor in purchasing or selling stocks and bonds.

In consequence, the efforts of public security commissions and private organizations of security dealers and brokers should, and often do, supplement each other. Yet heretofore there has been lacking the high degree of mutual cooperation between the two which is absolutely essential if the campaign against security frauds is to be made most effective. In this cause of closer cooperation I am present here today, to relate to you some of the efforts against fraud which the New York Stock Exchange, as the largest security marketing organization in the country, undertook many years ago,

and which it is now endeavoring to maintain and intensify. Nor is such a recital outside the genuine interests of your association. The Stock Exchange is a very old institution—one of the oldest in fact in the annals of American enterprise. From the nature of its activities, its experience in the security field has for over a century been continuous, extensive and completely practical. Time and time again the Stock Exchange, through the evolution of its own rules and regulations, and of the principles which underly them, has provided models which state legislatures have afterwards translated into public laws. Likewise, its own experience has frequently revealed the inherent difficulties to be encountered in the attempt to improve the general security business by new legislation.

It is because of the tremendous significance to law-makers and to public officials entrusted with the enforcement of the law, of the Stock Exchange's century of practical experience in the security business, that I will venture to describe to you why and how that market came into existence, and what its experience has taught it regarding the suppression of security swindlers.

II

The well-known British economist, W. S. Jevons, once remarked, "It is a singular fact that markets have been the subject of popular prejudice and moral objection, almost in proportion to the perfection with which they economize time, transportation and effort, and equalize prices." That this generalization applies with peculiar force to the New York Stock Exchange, present-day students of financial markets will scarcely dispute. It is therefore at the very outset necessary to explain to you what the Exchange really is and how its business is actually conducted. Perhaps the simplest way of approaching this complex subject is to state briefly

how and why the Exchange was originally created, although in so doing we must for the moment hark back to events which occurred more than a century ago.

Before and during the American Revolution there were no regular security markets in this country for the very good reason that there were practically no securities in which to deal. When, however, the United States gained its independence from Great Britain, this situation was quickly and radically changed. Under Alexander Hamilton, the first Secretary of the Treasury, the national debt was funded into an \$80,000,000 bond issue. In addition, our commerce required the establishment of American banks and American insurance companies. For this reason, only a few years after the close of the Revolution, about \$100,000,000 of stocks and bonds was speedily created. This new form of property inevitably demanded some regular and dependable market, where stocks and bonds in any amounts could always be bought or sold under conditions satisfactory to the public. Naturally enough, the earliest securities market in New York, as in other cities here and abroad, grew up amid the older and established commercial markets, and was accordingly conducted in mercantile auction rooms and in the coffee houses to which the merchants of the day resorted.

From the very beginning, the public found considerable difficulty in purchasing and selling securities, owing both to the peculiarly complex nature of the business, and to the intangible character of the property itself. The average man had little difficulty in buying or selling for himself the ordinary articles and commodities familiar to his daily life—such as furniture, foodstuffs, lumber or clothes. These forms of property were definite and tangible things; he could see them himself,

examine their physical characteristics himself, and judge intelligently by himself concerning their value. With securities, however, it was very different. The average investor lacked, and for that matter sometimes still lacks, the special knowledge required to form accurate judgments concerning the value of a government's interest-bearing debt, or the fractional ownership in as complicated a business as banking or insurance. He found out almost at once that in such buying and selling, he needed the professional services of an expert, for much the same reason that he required a physician when he was ill, or a lawyer when his legal rights were infringed upon. As a result, the stockbroker, who acts as a paid agent for his clients in just this way, sprang into existence almost as soon as any extensive body of securities existed in the country. Even today, the general lack of public knowledge concerning the peculiar technique of securities and security marketing accounts in large measure for the prominence which stock brokerage markets have attained in the securities business, as compared with purely dealers' markets.

The earliest stock market maintained by New York stockbrokers was a very humble and small-scale affair. Tradition asserts that it used to meet in the open street in lower Wall Street, hard by the wharves and coffee houses which at that time constituted the commercial center of the town. As early as 1792 these brokers signed a common agreement fixing a minimum commission on their transactions with the public.

This original curb market, however, left much to be desired. Its members belonged to no regular organization, nor could any rules of importance be adopted for the conduct of their business, since there was no way of enforcing them. Any one could stand in the public street, and buy and sell securities. Thus there was no control over the

kind of men engaging as brokers in this early market, nor over the kinds of securities in which they dealt, nor over the methods of dealing which they practiced.

In 1817 the real creation of the New York Stock Exchange occurred. A group of the more responsible stockbrokers in the original street market formed an association, hired quarters indoors where their business with each other could be conducted more comfortably and efficiently, and adopted a set of regulations for the conduct of the business based on high ethical standards. In addition to becoming a regular organization in this way, the collective group also acquired a power of self-regulation over its individual members by this step. Now, if a member broke the rules, he could be excluded from the room where the market met. Consequently, armed with this new ability to enact and enforce rules for the better conduct of the business in a multitude of different ways, the organization of stockbrokers could begin that gradual yet continuous evolution which has resulted in the highly organized and severely regulated stock market of our own days. It became possible to restrict the membership of the Exchange to men of standing and character, to limit the securities dealt in upon the Exchange to legitimate stocks and bonds and to rigidly enforce rules confining the business transacted on the Exchange between its members to legitimate operations. Thus, through the creation of the New York Stock Exchange, the stock market for the first time developed a collective will-power and a collective ability to realize in practice its aspirations for more efficient and more equitable standards of business conduct.

III

I have endeavored to explain these circumstances

which over a century ago led to the creation of the New York Stock Exchange, because in very fundamental ways they are still essential factors in its present-day operations and activities. In the past hundred years the Exchange has grown enormously. Its membership has increased from thirty-odd members at the start to the fixed number of 1,100 members today. The securities admitted to dealings upon it have mounted from a few stock and bond issues worth a few millions, to about 3,000 security issues, including domestic and foreign securities, valued at roughly 60 billions of dollars. Where in the beginning it represented only a local financial center, it is now a national and even international securities market. Where in the beginning the market wandered about the Wall Street district, driven by circumstances literally from attic to cellar, it is now housed in a lofty building of its own. In their physical form, the rules of the Exchange have in the meantime swelled from a few sheets of paper to a good-sized book. In all these respects, the Stock Exchange has shared in the unparalleled growth of the country, which, as a capital market, it has itself greatly facilitated. And yet the basic aims of the organization, both ethical and economic, have not changed. The Constitution of the Stock Exchange states that its purpose is—

“to furnish exchange rooms and other facilities for the convenient transaction of their business by its members, as brokers; to maintain high standards of commercial honor and integrity among its members; and to promote and inculcate just and equitable principles of trade and business.”

However much its activities or its facilities may have increased in the past century, the basic purpose of the Stock Exchange has remained unchanged down to the present day.

Moreover, a consideration of the exact situation

which resulted in the establishment of the Stock Exchange makes it clear why the Exchange is not and never has been a monopoly, as has been so often alleged. The organized market for securities on the Exchange, as we have seen, developed out of an originally unorganized market, which has nevertheless continued to exist close beside the Exchange ever since, and to actively compete with it. In few lines of modern business, as a matter of fact, is competition so keen and instantaneous as in that of providing a securities market. In addition to the New York "outside market" to which I have just referred, the New York Stock Exchange also has as regular competitors the twenty-odd other stock exchanges of the country, and to some extent the stock exchanges of foreign countries. The basis for the important comparative position attained by the New York Stock Exchange in the security business has consisted solely in its ability to render superior services to the investing public at reasonable costs.

Finally, ever since 1817 when the New York Stock Exchange was founded, there has been developing slowly but surely a private code of regulations for the securities business occurring between its members. This code, embodied in the Constitution and By-Laws of the Exchange, has developed under intense practical pressure. It has been tested by booms and panics, by sound and unsound currency, and by conditions arising from civil and foreign wars. Thus the rules of the Stock Exchange relating to the securities business are no mere paper program devised by some theorist. They could not have been formulated by any single mind, however brilliant, or by any conference, however wise and far-sighted. Before such a code could crystallize into its present form, there has been required a century's close experience in the business, hundreds of cases where various expedients were temporarily

tried only to be rejected as inadequate, and the consensus of opinion over many generations of men directly engaged in practical business.

It is generally recognized by historians that laws basically result from the customs of the people, and that in turn these customs are usually dictated and developed through economic imperatives. This is one reason why as a rule the practices and methods of legitimate private business regularly develop faster than do the laws which apply to them. Sometimes the law is blamed for "lagging behind business." In point of fact, that is precisely what the law should do, and in the main always must do. When law-makers translate into statutes some business custom whose fairness and necessity has been amply demonstrated, their laws will prove beneficial to everyone. But when, on the other hand, the law-makers try to jump ahead of economic and business developments, and enact experimental laws without a solid background of practical experience behind them, usually the laws so enacted speedily become a public nuisance and ultimately have to be repealed or disregarded.

Many interesting examples of this important and often forgotten distinction might be cited in the case of securities and securities markets; I shall mention only two. In 1913 the New York State Legislature enacted a law whereby a stockbroker who had bought or sold securities for a customer should be compelled on twenty-four hours' notice to give his customer a memorandum, stating the amount of securities involved, their price, the exact time of purchase or sale, and the name of the individual or firm from whom they had been purchased, or to whom they had been sold. This enactment simply translated into statutory form an old custom developed on the New York Stock Exchange and devised to meet certain definite problems and dangers in the business. In this it had proved effective over a

period of years. Consequently, the law which embodied this trade custom fitted practical conditions, and thus proved very beneficial to the interests of public investors, and almost absolutely destructive to the old style bucketshops.

But the law-makers have not always proceeded so carefully and so wisely. In 1812 the same New York State Legislature attempted to disregard completely the well-founded customs of the securities market by a law directed against short selling. Here the law did not follow business custom at all, but tried to forestall it and run counter to it. As a result, the statute against short-sales was found to be wholly unworkable, and highly undesirable from the standpoint of the very investing public which it was supposed to protect. Ultimately, therefore, the law had to be completely repealed in 1858, after having been disregarded in practice for many years prior to that date. Incidentally, Great Britain, Germany and France have all tried the same legislative experiment of prohibiting short selling, and have all been compelled to recognize their mistake and repeal the law later on.

Business customs are almost always more sensitive to developing economic conditions in trade than are formal law codes. When evils creep into business, new trade customs designed to restrict the evils in question will usually be developed quite quickly, by the private initiative of legitimate business. Thus, the danger to the public from unwisely conceived laws and statutory experiments is after all usually much greater than from the gradual manner in which the improvement of trade practices often occurs.

IV

I regret that it will be impossible for me to outline, even superficially, the entire complex and

extensive task in the marketing of securities, which the Exchange has so long conducted and facilitated. I will therefore confine my remarks largely to the particular phase of our work probably of most interest to you—our supervision of the admission of securities to trading in our market and the protection of investors.

Today, the “listing requirements” of the New York Stock Exchange—as they are called—are undoubtedly the strictest of any stock exchange in the world. Yet in establishing them, the position taken by the Exchange is naturally conditioned by its actual functions and its actual powers. These must be clearly understood. The Stock Exchange itself never buys or sells any securities. Its function consists in providing a market where its members can buy and sell legitimate securities for themselves or for the public, under well-regulated and equitable conditions. The Exchange must favor neither buyer nor seller, but at all times remain entirely impartial. Moreover, since so many Exchange members are acting, not for themselves, but as agents for others, the Exchange automatically must protect the interests of the investing public as far as this is possible. Naturally, the Stock Exchange cannot definitely guarantee the securities which it admits to its list, but it does ascertain that the securities represent a legitimate business or governmental enterprise.

A very striking change in the attitude of corporations has occurred in the last twenty years. Companies today are recognizing more and more the advantages of being frank with their shareholders and the public generally. To appreciate just how great has been the service rendered by the Stock Exchange to the public in urging wider and more complete publicity for corporation affairs for many years, one must compare our detailed and extensive requirements of today with the scanty

and limited requirements of a few decades ago. The Stock Exchange has always urged more adequate publicity for public investors. The long way that the listing policy of the Stock Exchange has come from the situation prevailing twenty years ago, is a credit to the Exchange and the leading corporations of the country alike.

Today, when a corporation desires to have its stocks or its bonds traded in upon the New York Stock Exchange, it must make a formal application for a listing. The company's representatives come before our Committee on Stock List, and through a printed questionnaire answer a wide range of questions concerning their securities, and the enterprises which the securities represent.

The code of regulations for listing on the Stock Exchange has developed over a course of many years, and represents the successful experience of several generations of the ablest American stock-brokers and security dealers. It covers a wide range, and endeavors in many different ways to protect the investing public. The form in which the stock or bond certificates are to be printed is carefully supervised, to obviate the danger of forgeries, and the Exchange insists that essential facts concerning the issue be clearly printed on the certificate's face in order to show the buyer just what he is buying. The Exchange further requires each company listing securities upon it to maintain two separate offices or agencies in Manhattan, one for the transfer and the other for the registry of the company's stocks or bonds; this precaution eliminates the danger of secret over-issuance of the securities to the detriment of public investors. These and many other requirements were devised years ago to meet specific and existing evils; had they not done so successfully, they would not continue to stand in our code of rules.

The questions asked concerning the company's

affairs include a detailed statement of its assets and liabilities, the exact character of its capital structure, its mortgages and leases, its past earnings, and similar matters. The purpose of the Exchange in obtaining this information is not to endeavor to judge whether the given security is or is not a good investment, or to ascertain whether it measures up to any pre-determined and inflexible rules in this regard, but simply to show the investors who may purchase it on the Exchange just what they are buying. The Exchange frankly knows of no infallible method of determining, beforehand, how any security will turn out. Business conditions change very swiftly in this rapidly developing country of ours, and prophecies regarding American investments are not to be lightly undertaken. Some of the standard and supposedly gilt-edged securities of a decade or so ago are now deposed from their former high estate, and have become quite dubious investments. On the other hand, some of the "ugly ducklings" of ten or twenty years ago are now among the soundest and most attractive securities on the Stock Exchange list. No degree of human foresight, no amount of human experience, can ever qualify anyone to pass absolute judgment on such matters as these. The Stock Exchange makes no attempt to do so. But it does insist that the public must be given the essential facts concerning securities which are admitted to its list. If information is afforded investors adequate enough to allow them to form an intelligent opinion of the security themselves, the Exchange has performed its duty.

The listing requirements of the Exchange, however, are not concluded when a security is admitted to our market. They continue in force. Each company to whom a listing is granted is required to publish an annual balance sheet, and also periodical earnings statements, if possible on a quarterly basis.

These reports and statements are not put out through the Exchange. They are sent to stockholders and are published in the papers so that everyone can see and read them. The Stock Exchange, in fact, refuses to receive any information which is not available to the stockholders of the company.

The code of regulations requisite for listing securities on the Stock Exchange is still being developed and improved. Gradually, as the Exchange discovers new and practical methods of protecting the investing public, it is adding them to its listing requirements. The body of experience represented by this listing code, privately developed by the Exchange over the past seventy-five years, has been and should be of genuine interest and value to the public officials like yourselves, who are approaching this problem of protecting the American public from the standpoint of the law.

But the protection which the New York Stock Exchange throws around the public's transactions in securities through its market, does not end with the scrutiny to which new securities are subjected prior to listing. Many other parts of the Stock Exchange machinery are also continuously at work in the endeavor to protect the investing public in all feasible ways.

The Committee on Admissions exercises great care that only men of standing and character shall become members of the Stock Exchange. In order to become a member a candidate must find a membership for sale either by a member desiring to transfer his membership, or by the Committee on Admissions. He then enters into a contract which fixes the price, and provides that the transfer shall take effect on approval by the Committee on Admissions. Before a candidate's name is acted upon it must be posted for two weeks in order to give members a chance to present information they may

have concerning him and to express their opinions. The candidate must pass the Committee on Admissions and receive the affirmative votes of ten out of the fifteen members of that Committee.

The Committee on Business Conduct has two functions which may be of interest to you. The first is to take account of transactions on the Exchange and the course of prices, with a view to determining whether improper transactions are occurring. I do not attempt to say that members of the Exchange never take part in transactions that ought to be condemned and are condemned by the standards of business conduct maintained by the Exchange, but the Exchange, needless to say, is thoroughly vigilant in preventing and punishing any such unethical conduct by its members.

The second duty of the Committee on Business Conduct, to which I wish to call your attention, is to take cognizance of the financial condition of members of the Exchange and their firms, so that such members or firms shall continue in business only so long as they can do so with safety to the public and their fellow members. The Committee on Business Conduct has the power to require, and at least twice in each year does require, every member of the Exchange or firm registered on the Exchange that conducts a margin business, to answer a questionnaire which has been devised for the purpose of showing accurately the financial condition of the firm without disclosing information as to names of customers and so forth, unnecessary for the purposes of the Committee, or involving the disclosure of the private affairs of their customers. The Committee has the power to check the correctness of a questionnaire by actual examination of the books, but that is a power which it does not exercise unless the answers to the questionnaire disclose the necessity for further examination.

This questionnaire is of great and increasing importance. It has frequently placed in the hands of the Committee on Business Conduct information which has enabled them to require a firm to increase its capital or otherwise strengthen its financial position. I do not think the time will ever come when failures on the Exchange will be entirely impossible, but the use of the questionnaire is a long step in the direction of minimizing such failures.

Finally the Committee on Quotations and Commissions oversees the gathering and distribution of security quotations originating on the Exchange. Reporters on the Exchange under control of this Committee make note of the transactions occurring there, and send them out over the stock tickers to all parts of the country. In this way the nation is provided with accurate, complete and almost instantaneous price quotations covering the business transacted in the open market on the Exchange. In addition, the Exchange acting through the Committee on Quotations and Commissions reserves the power to disapprove applicants for the quotation service furnished by the stock tickers, in order to prevent its employment by improper persons, particularly bucketshop operators, to deceive and swindle the public. The quotations have never been denied to any man desiring them for an honest purpose. On the other hand, this restriction by the Exchange of the grant of its ticker quotations has in the past proved one of the Exchange's most effective weapons in its long fight against the bucketshops.

V

It seems unnecessary to state that every species of fraud has long been prohibited among Stock Exchange members, and that the rare cases when any evidence of unethical dealings by Exchange

members has developed, have been speedily and severely punished. The real problem with which the legitimate firms and institutions that compose the center and heart of Wall Street have regularly been confronted has been to drive out of business the swindling concerns which infest the edges of the financial center. Security swindlers frequently attempt to appear in the eyes of their victims as reputable Stock Exchange or private banking firms. In this they have succeeded sufficiently to create prejudice against the legitimate firms and institutions of Wall Street throughout the country, and have done serious harm to legitimate American finance. Very naturally, the security swindler has no more consistent or persistent enemy than the legitimate security firms in the New York financial center. I have pointed out that Stock Exchange members obtain business only on the basis of public confidence in the actual service which they render. The honest stockbrokers and honest dealers realize that their own prosperity, and indeed their very existence, hinges upon the suppression of fraud in security dealings generally.

The Exchange, as I have explained, is a private body. Over its own members it has an absolute authority, and it can impose even more severe penalties for fraud than could usually be obtained through action in the courts. But there its authority naturally and necessarily stops. The New York Stock Exchange has no authority at all over individuals or firms who are not its members—and the security swindler never even applies for such membership, much less obtains it. The Stock Exchange will go to the very limit of its powers in fighting the fraudulent security dealer. The Exchange has spent large sums of money in cooperation with other interests, or alone, in the attempt to halt fraud. Nor is this any new policy on the part of the Stock Exchange. It has carried on a

continual fight against the bucketshops for half a century, and even before that time was regularly engaged in fighting other forms which the evil of stock swindling had assumed. The New York Stock Exchange has always stood ready to cooperate in any feasible and genuine effort to halt fraud, and always will. Whenever the Stock Exchange has opposed new laws aimed at the suppression of fraud, this attitude has been taken solely because its practical experience has convinced it that the proposed legislation would not accomplish the object for which it was designed and would severely hinder legitimate business.

There is, however, one phase of the problem of halting security frauds upon which the Stock Exchange is thoroughly convinced, and that is the necessity for continuously active enforcement of existing laws and of severely punishing the swindler. In the effort to frame supplementary legislation, the basic need of thoroughly enforcing punitive legislation must not be overlooked. Most security swindlers are too callous to be reformed by ethical appeal, however powerful, and too clever to be forestalled by mere legislative enactments, however subtle and refined. But there is one thing that the security swindler stands in terror of—and that is long jail sentences at hard labor. It is a misapplication of mercy to deal out trivial sentences to swindlers in the courts; it only results in the establishment of practical immunity for the continuance of such abuses, and in consequence places a substantial premium upon crime. Undoubtedly one fundamental reason why security frauds are more prevalent here than in most of the large European countries, is because there is no illusion abroad as to the necessity of severe punishment for the seller of fraudulent securities. What America needs in handling our seemingly perennial problem of security frauds is more jail sentences,

quicker jail sentences and longer jail sentences. Not until the security swindler begins to get hurt will he quit the fascinating pursuit of "easy money." When he knows that if he engages in swindling, he will in the long run be severely dealt with in the courts, he will hasten to abandon a business so personally dangerous to him.

This position taken by the Stock Exchange has been completely borne out by the experience of the U. S. Post Office Department, especially under Postmaster General New, in its splendid efforts to halt the use of the United States mails to defraud. The essence of the Post Office's vigorous efforts has lain in going after swindlers relentlessly, and seeing that without exception they are brought into court and severely punished. The Post Office inspectors practice unceasing vigilance and immense persistence. The Attorney General of the State of New York, Mr. Sherman, has vigorously and effectively enforced the Martin Act against security swindlers. He has vitalized this law into a forceful repressive measure and its strict enforcement has saved many investors from the allurements of spurious securities peddled by unprincipled swindlers. In the County of New York, District Attorney Banton has waged war on bucketshop-keepers and financial crooks and secured numerous indictments and convictions. He has driven to cover many others who feared the law, when thus aggressively enforced. I do not agree with Mr. Banton on certain of his proposals for new legislation affecting brokers and securities dealers, but we are both working towards a common end, the protection of the public. I believe that in time all legitimate business and all public officials will work in close and active cooperation and that differences as to method will not interfere with the effective results that must flow from real team work in the public interest.

VI

To revert to something which I have mentioned already, there are two regulatory codes now in operation in the security business; first, the external public laws enacted by the Federal and State governments of the country; and second, the body of trade practices and methods developed internally and privately by the reputable individuals and firms in the business. Neither can stand alone, if their common purpose—the elimination of security frauds—is to be actually achieved. The New York Stock Exchange and other similar security organizations can formulate and enforce definite and practical rules for their own membership better than the State can possibly do it for them. The legislatures can enact laws relating to securities applying to everyone and these laws can be enforced fearlessly by the constituted officers of the law. In enacting new laws there is a difficulty in the lack of actual experience in a complex and sensitive business, and consequently in the formulation of laws which experience has shown will prove effective and practical and not merely restrictive and burdensome. The enforcement of public laws relating to security transactions makes desirable and often necessary an intimate contact with and knowledge of the actual business, and these sometimes can be attained by public officials only through an expenditure of public funds much larger than most legislative bodies are regularly willing to provide. As long, therefore, as the public legal code and the private business code relating to supervision of security transactions attempt to function entirely separately, it is unlikely that either will prove entirely adequate, or succeed in positively achieving the common aim of putting the swindler and the crook definitely out of business.

What seems to me most necessary, and most likely to accomplish this end, equally desired by the

government and by legitimate business, is a thorough-going cooperation between the government and business in the whole matter. In making this suggestion, the New York Stock Exchange believes that its long experience in the security marketing business, the rules governing its activities which have crystallized from this experience, and its numerous methods and trade practices developed to carry on its present indispensable economic functions, constitute a body of practical knowledge relating to the proper regulation of security transactions which may well prove of great value in any national and concerted attempt to suppress security frauds. To you, the Security Commissioners of the States, collectively or individually, the Exchange therefore extends its promise of complete cooperation in every vigorous and practical effort which you contemplate to rid the land of the security swindlers who now threaten the very foundations of national thrift and business enterprise.

SECURITY SWINDLING: ITS MENACE AND ITS CURE

*Address before Representatives of Financial
and Commercial Organizations at a
Dinner at the Attic Club, Chicago,
February 24, 1925*

SECURITY SWINDLING: ITS MENACE AND ITS CURE

Financial swindling is no new problem in the United States. Under one guise or another, it has been practised for the past hundred years, and in proportion as our national wealth has grown, the inroads which it has made each year upon the savings of the country have increased. The swindling evil has spared no section of the country and no class in society; among the helpless and the ignorant it has been especially prevalent. There is no field of business which has not sooner or later found itself invaded by this most dangerous parasite of the business world. Every successful new invention—the automobile, the radio or the latest electrical device—is immediately seized upon by a swarm of crooked professional promoters whose only desire is to unload fraudulent securities on a wave of public enthusiasm. The outward forms adopted by swindlers to camouflage their operations, are continually changing. One year the public is invited to sink its savings in alleged oil drilling, or new inventions, or foreign exchange trading. The next year it may be land speculation, rotten mortgages, wildcat mining ventures, or security and commodity bucket-shops. Yet, under all these outward and rapidly changing forms, the swindling evil itself persists and even grows stronger in the land from year to year.

Very naturally, no exact statistics have been or can be kept, as to the actual aggregate sum of money lost each year in financial swindles. Most victims do not realize very quickly that they have been tricked, and are apt in their chagrin to conceal the fact. Occasionally, however, in some one locality, or in connection with some single line of swindling,

the curtain will be lifted. A case in point was the recent exposure of the colossal Fort Worth oil swindle. Here the medium employed by the swindlers consisted of several hundred bogus oil companies, capitalized at approximately \$275,000,000. Of this capitalization, about \$75,000,000 represents a total loss to security buyers all over this country. In four years alone, failures of oil promotions in the Southwest are said to have numbered over 8,000, and the so-called "sucker lists" employed by the salesmen of their shares are stated to have contained over a million names. And yet these extraordinary oil swindlers in the Southwest are only a single specific item in the unknown but obviously enormous toll levied each year on our national savings by the fraudulent security vendor.

Many estimates have been made of this gross income of the security swindling industry in America. The U. S. Treasury has stated that in 1918-1919 approximately \$400,000,000 of Liberty Bonds were taken from investors through various swindling methods. Some years ago both ex-Secretary of the Treasury W. G. McAdoo and the Fraudulent Securities Committee of the Investment Bankers' Association agreed in estimating the annual public loss at \$500,000,000. But the U. S. Post Office Department, I believe, as well as several prominent private business men, have since been inclined to double this figure.

At this point it were well to halt a moment, and consider the actual significance of these enormous figures. The unprecedented magnitude of war finance has accustomed us all to seeing figures in the newspapers running into the billions of dollars, and to discussing them in a perfectly casual manner. And yet our imaginations have not yet become accustomed to really grasp the significance of these huge sums. A half-billion dollars is equivalent to more than an eighth of all the legitimate new cor-

porate securities publicly sold in this country during 1924, and a sixth of the securities newly listed on the New York Stock Exchange last year. It is more than the internal revenue collected by our entire Federal Government prior to 1916. But the exact amount of money filched from the American public each year is not so important to ascertain, as it is to realize the comparative extent and importance of the swindling game in this country today. Whatever the public's losses each year may actually be, it is perfectly plain to all of us that they are vastly greater than they should be.

The tremendous harm wrought by the financial swindler has often been recounted. He imposes the most cruel and intense hardships upon helpless individuals—upon widows and invalids and others whose only fault is over-trustfulness in their fellow-man. He profoundly discourages steady thrift and conservative investment, by spreading abroad false reports of millions to be gained through the surrender of a few dollars, and then by stealing these individually trifling sums afterwards. The swindler makes the process of investment more dangerous to the investor, and the process of security financing more costly to both governments and business enterprises. Moreover, his operations continually create and ferment a dangerous public prejudice throughout the land against all successful business, all legitimate finance and trade, and even against government officials themselves. A menacing attitude toward the distribution and ownership of wealth is fostered which, capitalized by the self-seeking demagogue, threatens our form of democratic self-government and the very basis of our prosperity and our civilization. This problem of fraudulent investments is consequently no side-issue for bankers and stock-brokers to lament occasionally across a well-garnished banquet table. It is an evil, nation-wide in scope, universal in its power to harm, and of sufficient

magnitude to demand the most earnest and intense efforts of both the government and private business interests to combat.

Of course, every financial swindle is always two-sided. There is always the trickster with his desire to deceive through glowing promises, and the victim with his fatal weakness for being imposed upon by a gullibility which temporarily outruns his common sense. In consequence, there are two basic ways of halting the evil—either to punish crooked intentions and acts speedily with severe jail sentences, or to cure public credulity regarding investments through education in economic and financial matters. In the long run the latter method of education is perhaps the more fundamental, and should be given most careful consideration and continual impetus by those who are on the trail of the fraudulent security salesman. Yet educating the public in the infinite intricacies of modern investment is bound to be a very slow process. While every effort should be made to educate the new army of American investors, resort must meanwhile also be had to the first method of going after the crooked promoter and salesman, and punishing them swiftly, certainly and severely.

II

Just as security swindling in this country is no new problem, so too there is nothing novel about descriptions or denunciations of it. A vast number of speeches and articles directed against security frauds have appeared for the past twenty years, but without substantial effect in checking the evil. Even more surprising has been the failure to fully halt security frauds experienced by the many public and private bodies which from time to time have endeavored to do something more than merely talk against swindling.

First and foremost of these agencies which have

endeavored to eliminate security frauds has been the Federal Government itself. The evil comes into contact with many of our national governmental organizations, and threatens many of their public duties and functions. On numerous occasions the Government has shown deep concern over the extent to which the public has been preyed upon by financial frauds. The Treasury Department and the Department of Justice both have a vital interest in checking this nation-wide abuse. If the latter Department could see its way to setting up a special bureau devoted to the prosecution of fraud cases, much assistance to fraud-fighting the country over could be rendered.

But, as far as financial frauds are concerned, the most continuous and effective arm of the Federal Government has undoubtedly been the Post Office Department. It has been estimated that about 80 per cent. of the sales of fake securities in this country are promoted through the mails, and to check this phase of the swindler's operations the Post Office Department has shown itself both vigorous and effective. Many of the most prominent exposures and prosecutions of crooked promotions have been initiated by the keen and tireless inspectors of the Post Office. But in its altogether admirable effort against bogus investments, the Department has naturally been limited by its existing appropriations. If arrangements could be made whereby the Post Office Department could be afforded sufficient funds to organize and detail a force of ten or a dozen able inspectors to specialize in this work of ferreting out and bringing to book the engineers of fake stock flotations, a very great public good could be accomplished.

The States of the Union have also made earnest and genuine efforts to cope with the problem. They have created special Securities Commissions, and appointed special officials, in the endeavor to safe-

guard public investors against illegitimate security salesmen, and armed these officials with various sorts of laws. In this way, another very valuable forward step has been taken toward the ultimate solution of this old and persistent problem, and if something short of success has been experienced, the reason is mainly to be found in the conditioning circumstances under which most of these men have worked. Their appropriations for such an extensive undertaking have as a rule been insufficient. Sometimes the laws which they have been called upon to enforce have been difficult of interpretation and unfeasible of practical operation. Too often the stress has been laid upon theoretical preventives, rather than upon actual penalties for wrong-doing. Moreover, the operation of State-anti-fraud laws have of necessity been confined to single localities in the country. The various Securities Commissioners themselves have been among the first to recognize the difficulty of proceeding piece-meal by purely State measures against what is very obviously a national evil, and have endeavored by national conferences to obtain a greater degree of nation-wide teamwork and co-operation in their fight against financial frauds.

But the governmental authorities, Federal and State, have by no means conducted all the effort exerted against the swindling evil. The responsible private business associations and institutions of the country have long realized its public menace, and are unanimous in desiring to see it reduced to a minimum. But to date, this feeling has been only too apt to result, not in concrete programs or consistent achievements, but merely in vague resolutions urging somebody else to do something or other.

The New York Stock Exchange in this respect has a long and tangible record of actual accomplishment. For more than a century it has formulated and enforced high standards of business conduct among its members. In addition, it has

in several ways been able to make its weight felt among non-members, through its various contacts with the public. For many decades the Exchange has exerted an increasingly severe censorship over the securities admitted to trading and quotation on its floor, and a steadily greater compulsion upon corporations seeking to list their securities, to give widespread publicity to the essential facts of their business. Because of the present searching listing requirements of the Exchange, crooked stock promoters give the institution a wide berth, and in consequence, in the ordinary course of their work, Exchange members or officers rarely come into contact with either the illegitimate dealer in securities, or his fraudulent wares.

The crooked broker, however, is forced into a closer contact with the Stock Exchange, through his desire to obtain Exchange quotations, and perhaps a private wire to an Exchange firm, so as indirectly to employ the facilities of the Exchange in his nefarious work. For almost fifty years the New York Stock Exchange has fought the bucketshops. Through its control over its ticker system, and the wire connections of its members, the Exchange has consistently refused, frequently in the face of intense pressure, to grant these facilities of its market to alleged "brokerage firms" which the courts have afterwards shown to be nothing but bucketshops. It has removed tickers and wires from fraudulent non-member concerns in various parts of the country, some of whom had even obtained a license from the State in which they were operating. In any future concerted attempt to close up the bucketshops and keep them closed, the Stock Exchange has much data upon this variety of swindler to contribute.

In recent years, however, the effort which the Stock Exchange has exerted against security swindling has broadened out from simply avoidance of listing spurious securities, or of granting wire facili-

ties to illegitimate dealers, into a less specialized campaign against financial frauds in general. One step in this wider effort has been the initial sponsorship which the Better Business Bureau of New York obtained in 1922 from the New York Stock Exchange, which at its inception was mainly responsible for its financing. The Better Business Bureaus, each located in a leading American city, are supported by private subscriptions and contributions from local business institutions and individuals and devote themselves to an unrelaxing hunt for and prosecution of swindlers of all types. The New York Bureau has proved very active in security fraud work. Its function has been to ferret out cases of apparent swindling, make investigations and if possible secure evidence, and turn this material over to the Attorney General of New York State, the U. S. Post Office Department, and other prosecuting authorities. Since its establishment in 1922, the New York Bureau has handled approximately 5,000 inquiries for information about doubtful securities and dealers, and has accumulated information upon roughly 15,000 individuals and companies. It has been estimated that in 1924 alone, \$50,000,000 was saved to the people of New York State as a result of the Better Business Bureau, in cooperation of course with public authorities and other fraud-fighting forces.

Very recently, in its continued endeavor to accomplish something tangible in the fight against swindling, the New York Stock Exchange has set up a department which invited the submission of fraud cases and evidence from all parts of the country, and which aims, in cooperation with other agencies, to make every effort to investigate them and if fraud is uncovered, to prosecute its perpetrators to the full extent of the law. I am not therefore simply indulging in rhetoric when I state that the New York Stock Exchange does not intend to allow this campaign against financial frauds to

gradually and quietly die out. The Exchange intends to carry on this fight against fraud indefinitely, until it is crowned with a satisfactory conclusion.

Nevertheless, the Stock Exchange is not subject to any delusions as to the magnitude of the task it has undertaken, or to its own probable ability to overcome it single-handed. With all the earnestness in the world, the New York Stock Exchange can exert only a limited influence in national and public problems of this sort. Over its own members it possesses ample power, but over other individuals and non-member firms, not subject to its special jurisdiction, it can exert only a limited authority. The Exchange has and seeks no general control over the security business of the country, and any attempt by it to acquire or wield functions rightfully belonging only to the government, would subject it to immediate and justifiable criticism by the government and the public alike. Yet in any national effort to eliminate stock swindling, the Exchange can perform valuable subordinate and corollary functions, and this it is our most earnest desire to do. It is most discouraging for the Exchange to recall its many years of effort against security swindling and its constant endeavor to work out a genuine solution of the problem, and then see the bogus broker, the crooked promoter, and the swindling security salesman, continue to flourish, prosper, and apparently increase in the land.

In speaking of the effort of private business organizations to halt the operations of these fraud-working individuals, I have confined my remarks to the part played by the New York Stock Exchange, because with that I am naturally most familiar and most concerned. Many other business organizations have of course been working at the same broad problem from other angles, and largely along parallel lines. The Associated Advertising Clubs

of the World have contributed to the cause their fine enthusiasm, and through their Vigilance Committee have achieved a splendid record of tangible accomplishment through the use of fearless, concrete and hard-hitting publicity. The Investment Bankers' Association, through its Fraudulent Securities Committee, has wrestled with the swindling evil as we have in the Stock Exchange. Here and there through the country Chambers of Commerce and other organizations have not merely made speeches and passed resolutions on the subject, but have vigorously driven the swindling security salesman from their particular localities. Nevertheless, despite all that has been done, I think that all these various organizations who have interested themselves in the fight against financial frauds will agree with me when I say that only a beginning has been made in the process of really eliminating them from the United States.

It is therefore time that we should reconsider the basic features of this problem in order to ascertain why all the effort, time and money that has been expended by both the government and private business interests in the war against swindling should have apparently availed so little against it, in order to resume the campaign along lines which experience has indicated to be more efficient and likely of ultimate success.

As I have considered the problem, there seems to me to have been two chief weaknesses attending anti-swindling campaigns in the past. The first of these has lain in the lack of cooperation between the many independent agencies engaged in the struggle. It has not been one powerful, unified effort, but rather a series of localized and sporadic efforts separately conducted, each more or less parochial in its scope and conditioned by the limitations and the private interests of the body conducting it. From this fact it has followed as a natural

consequence that the results of this very considerable aggregate effort have been felt only temporarily, only in certain sections of the nation, and only in certain lines of business. The inevitable reflection is, why cannot all these at present separate campaigns against security frauds be co-ordinated into a single, concerted, nation-wide campaign in the interests of economy and efficiency? It would surely seem that, between us all, there are sufficient funds, sufficient expert employees and directors, sufficient knowledge of the existing evil and sufficient determination at least greatly to reduce its present magnitude, if all these resources could be brought simultaneously to bear upon the problem.

The second principal weakness in these past anti-swindling efforts which I have observed, is the lack of any regular and permanent machinery for receiving complaints and collecting evidence on a national scale. Very often, of course, the victim of a security swindle pockets his losses in silence through a foolish sense of pride, but even more often his case never comes to the attention of those who could perhaps help him, or at least see to it that the swindler was punished, simply because he does not know what to do or to whom to go. Somehow the public must be taught to cooperate with the agencies which are fighting fraud. Business men, and even government officials, cannot hunt out these cases where fraud has been committed—they must come readily and speedily from the people themselves.

The lack of universally accessible agencies for disseminating sound advice regarding investments, and for assisting as far as possible the swindlers' victims, has been very generally felt by those of us who have been engaged in anti-fraud campaigns. Nor is any ready machinery apparently at hand. It is all well enough to say to the inexperienced security buyer, "Before you invest, investigate,"

—the trouble is, the public doesn't know how to investigate, and needs active rather than merely passive assistance. Sometimes, too, the small investor has been told "Consult your banker," which in many cases is sound advice. But, without unjustly maligning a great and kindred profession, this counsel is not always perfect. American banks of very considerable size and standing indeed, have sometimes heedlessly given "bank references" to firms later proved to be bucketshops, and to individuals now serving time in State and Federal penitentiaries. I refer to these cases, not in any spirit of captious criticism or with any implied thought as to the superior intelligence and character of stockbrokers or any other class of business men, but simply to emphasize the fact that if we are to fight frauds successfully, we cannot simply hold conferences and pass the responsibility along for the nation's bankers to shoulder. Some chain of agencies, impartial, experienced and financially disinterested, must be provided, through which the suspicions and complaints of the public can flow quickly and readily to the attention of those who have undertaken the fight against swindling on a national scale.

III

In attempting to formulate a constructive plan against financial frauds, the fundamental stake which American business has in the problem cannot be too often emphasized. The swindler menaces the very foundation of mutual trust and confidence upon which modern industry and society alike have been built. It is not enough, therefore, for business men simply to call the attention of government officials to the swindling evil, with vague promises of good will and future assistance. Fraudulent dealings are a perversion of legitimate trade, and if the country is to be purged of them, business men must expect

to give freely of their time and their money. We cannot limit our efforts in behalf of American investors to mere lip-service. After all, most of us have been actually doing only a little to correct existing abuses, and we cannot expect to wrap our cloak of integrity about us, stand aloof, and be taken at our actual or our own estimated value, by the security swindler's countless victims. In this matter we all have a civic and economic responsibility. We must come out in the open and fight the financial swindler. We have a public duty to perform, and we need not applaud ourselves as patriots if we do it. Neither should we preface our engaging in anti-fraud work by seeking specific favors for ourselves. Our own interests, it is true, are gravely affected. But bigger and more important than this is the duty which we owe to the investing public and to the country itself

We are apt to call loudly for "law enforcement," and then dismiss the matter from our minds. But when there is a riot, good citizens volunteer and are sworn in to preserve the peace. In the financial world there is a riot of swindling, which has gotten beyond the powers of constituted authority to meet. It has become plainly our duty to step forward and help the constituted authorities with something beside criticisms, exhortations and after-dinner speeches.

A very frequent and usually very foolish habit of many persons in this country is to demand new legislation for all the ills of society and trade. Very often this clamor for new laws is merely a not over-subtle method of attempting to evade responsibilities. If experience has demonstrated anything at all in connection with financial frauds, it has been that merely revamping our laws will not suffice to deter the professional crooked security salesman. Already our fraud laws are vastly too complex, formulated as they have been by our Federal Govern-

ment and our forty-eight separate State Legislatures. The financial underworld already knows how to benefit by the existing chaotic complexities of our local laws, and if any change in them is to be sought, it should be with the aim of standardizing and simplifying them, rather than rendering them still more abstruse by further experimentation.

It is true that existing legislation is not always either effective or practical, and in addition sometimes is very burdensome to legitimate business. But the way to meet this situation is to seek out the law-makers, show them the real remedies for the swindling evil, and the inutility or danger of present laws. Almost invariably public officials will meet us fully half-way, and together we may work out a sane solution of this great problem. Among our public men there are only a few demagogues. Many who are branded as such are sincere men, possibly misguided or misinformed. Moreover, not all of those with whom we may disagree are necessarily demagogues because of that fact.

In any case, laws are useless unless they are enforced, and under existing conditions the adequate enforcement of laws now on the statute books without the hearty and genuine cooperation of American business, is practically impossible. Good laws are of course a necessary foundation to the permanent elimination of fraud, but they are not in themselves any cure for fraud at all. There is no genuine public benefit to be derived from further pursuing the fascinating yet misleading will o' the wisp of Utopian legislation. The practical, the constructive step to take, is to get into this security fraud fight with both fists ourselves, and become active allies rather than arm-chair critics of the public officials who are intrusted with the enforcement of the many comprehensive and sound laws which we already have.

As an indication of the principles to be followed

in inaugurating a real cure for swindling abuses, I wish to allude again to our recent experience in the Stock Exchange—rather for the psychology and the theory of it than for its actual accomplishments in the short space of its existence. A few months ago we established a bureau whose function it should be to centralize the efforts against fraud, afford a definite headquarters for them, and a mechanical means of linking them up and furthering cooperation among them. This step has been widely and very favorably commented upon in the press, and has led to a generous response from the public. Letters, specimens of promotion advertisements and circulars, and similar material have poured in to us from all sections of the land. The very general enthusiasm with which our efforts have been received by the public quite clearly indicates that work along the lines of national cooperation has in it real possibilities of success against financial swindlers. But the magnitude of the task is equally apparent. Some means of enlisting the interest and cooperation of all the great business associations and organizations of the country is needed. In addition to establishing close working contacts with the U. S. Post Office Department, the Department of Justice, and the Securities Commissioners of the States, the help of our savings banks, investment and commercial bankers is needed, as well as of our boards of trade, chambers of commerce, rotary and advertising clubs and trade organizations of all sorts. We must also have the help of our manufacturing associations, of organized labor, of farmers' organizations. Spasmodic, localized efforts to root out financial frauds will not accomplish any permanent cure; the effort must be nation-wide, all-embracing, intense and enthusiastic. Those who will not put their shoulder to the wheel with us should stand aside.

Our practical experience will at once indicate to us that the only way in which active, universal

cooperation of this kind can be attained and maintained, is through a definite and permanent national organization, directed by a broadly representative committee, conducted by a paid manager, and located in just such a central location as this great city of Chicago enjoys. The functions of such an organization, as I see it, should consist in attempting to unify our many separate anti-fraud efforts, by providing agencies all over the country to which the victims of fraud can appeal, in educating the public to employ them, in collecting these cases on a national scale, and vigorously pressing for their speedy and severe prosecution all over the United States. My real mission in coming across the country to address you tonight, is more than anything else to make this specific proposal to you.

In addition, such basic educational work regarding investments as is feasible should also be attempted. But the best and most direct service we can perform for the public is in freely spending our time, money and energy in seeing that the professional swindler is put behind the bars where he belongs. One swindler jailed is of more real benefit to the community than any amount of eloquent discourses on what somebody else ought to do about the fraud problem.

The swindling evil is no easy abuse to eradicate. As long as some men are credulous and uninformed, and other men are rascals, a certain amount of swindling will probably continue to occur. But the year in and year out operations of the professional swindler must and can be halted. Through cooperation and organization, we can and should see to it that the punishment for frauds is made sufficiently certain and severe to fit the crime, and not suffer those who filch millions from the public through the sale of bogus securities either to escape punishment entirely or else undergo only a few months' imprisonment—which amounts to only

a license fee for engaging in the business. After all, the swindler seeks only easy money under conditions where the risk is slight. He is not interested in pursuing a vocation whose profits are difficult to secure, and whose risks are swift and severe. An absolute elimination of financial frauds we will never see, but a vast reduction in them lies, I believe, well within our power to effect. At any rate, the swindling evil today, with its vast wastage of funds, its deep discouragement of human hopes, its increasing menace to the stability of our business world and even to our form of government, is a challenge which no business man who can look further than his own balance sheets, can well refrain from accepting. It lies in our hands, gentlemen, to accomplish a great work in behalf of the entire public of this country. The situation calls for action. I trust we will not prove incapable or irresolute in the manifest public duty which lies so plainly before us.

CREDIT AS A NATIONAL ASSET

*Address before The Credit Men's Association
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CREDIT AS A NATIONAL ASSET

In the last decade there has been a very extraordinary growth in the study of credit as a regular factor in business operations. From this, a new profession—that of credit men—has evolved to handle the very important and sensitive credit problems upon which the stability of all business rests. It is a further sign of the progressive times in which we are living that such credit men should form associations to maintain high standards in their work, to increase their own technical knowledge of credit extension, and to become familiar with credit conditions all over the United States.

The elaborate and constantly expanding technique of this new profession should not, however, obscure the wider aspects of our credit problems, and tonight therefore I will discuss credit not from a technical or specific standpoint, but broadly as a major factor in American society and civilization, and incidentally some of the things which disturb credit and are a menace to it.

I

The word "credit" can be variously defined, as one soon learns when he resorts to the dictionary. The term has acquired many different specific meanings through the many ways in which it is concretely employed. Fundamentally, however, credit may be broadly defined as a mutual condition of trust and confidence in the integrity and ability of our fellow-man.

In this general sense, all human enterprise and indeed all civilization is directly dependent on credit. In recent years, the United States Government was able to sell over twenty billion dollars of Liberty

Bonds because millions of people were convinced that it would keep its word and pay off their principal and interest when due. Without such employment of our government's credit, the war would have inevitably been lost. Today we all accept as the equivalent of gold coin the paper bills of the Reserve Banks and of the United States Government, because we believe the promises of banks and government alike to exchange them for gold on demand. We even go further and accept checks drawn by individuals—another instance of the daily employment of credit. Over 90 per cent. of payments made in the United States are by check, a fact which shows the high degree of mutual trust and confidence which obtains today throughout American business. Even our life's savings we regularly invest in such credit instruments as stocks and bonds, which are in the last analysis actual or implied promises made to us by other people to pay us a regular income. One of the most complete resorts to the use of credit is made daily on the floor of the New York Stock Exchange where millions of dollars' worth of stocks and bonds are bought and sold every day with perfect safety, but entirely on the basis of verbal contracts, and sometimes merely through a nod of the head.

This universal employment of credit today is no sudden or accidental development in the United States or elsewhere. It has been attained only through a long and painful evolution, the history of which is marked with many experiments, many failures, and many break-downs, running the whole gamut of human carelessness and folly. It was not until about 1900 that American paper currency was really stable and adequate, while our banking system and the financial methods of most of our business corporations did not attain real stability until an even later date.

But the gradual perfecting in our methods of

handling credit problems has not merely been responsible for the steady improvement of our modern financial machinery. It has exerted a profound influence on the nation's commerce and industry. It has been through the use of credit rather than of actual money that the United States has been built up in the past, and in the future this will be true to an increasing extent. For this reason, America's credit, as well as our machinery for handling it, constitutes one of our most precious national assets.

We are all accustomed to recount with pride the swift growth of this country from obscurity to pre-eminence, and with the material manifestations of our astonishing national growth, we are all familiar. We take a natural pride in the lofty sky-scrapers of our great cities, in our vast railroad systems, in our huge mills and manufacturing plants, and in the unique wholesale methods employed on our great farming areas. Yet these things by no means constitute the whole story of America's extraordinary growth, many factors of which are not thus visible to the eye and are therefore apt to be forgotten.

Business men are sometimes inclined to smile at the clergy when they stress the eternal importance of cooperation, faith and integrity in all human affairs—even including business. Such a view is apt to seem irrelevant and idealistic. Nevertheless, anyone who carefully analyzes the way in which business is carried on in this country today is bound to be impressed at once with the overwhelming importance of just these intangible and moral factors. As a matter of fact, just this element of mutual trust in each other's honesty and ability lies at the bottom of all our employment of credit, and therefore, throughout the evolution of American business, these ethical factors are and have been indispensable considerations. This country has been built up by American faith in the future no less than by American steel and iron, and by our ability to

cooperate with each other no less than through rich natural resources and new mechanical inventions.

II

In connection with credit in this collective sense, passing mention should be made of the financial center of the country in New York City, where credit problems are ordinarily the largest, most difficult, and most pressing. What is this Wall Street of which we read so much in the papers? Of which such dark and sinister stories are continually repeated? Whose mere name is considered a sufficient explanation of any event which cannot be readily understood? Essentially Wall Street is a business center for handling credit, where one promise can be exchanged for another, and where almost any promise can be estimated at its true worth.

This may seem a very peculiar way to define the business of Wall Street, but a moment's reflection will convince you of its accuracy. When you deposit in your bank paper bills or checks, exactly what are you doing? Simply exchanging promises of individuals or the government to pay for the bank's promise to pay. When you borrow money at the bank, what really occurs? You are exchanging your promise to pay for the bank's promise to pay. What is the real significance of making a security investment? You exchange your check, which is your promise to pay money through a bank, for the promise of some government or company to pay the interest and principal on its bonds, or the implied promise of a corporation to pay dividends on its stock as it can earn them, and as such payment is considered advisable by its directors. Therefore as I have pointed out, the great money and security markets of Wall Street have as their principal business this exchanging of one promise for another

and this estimating of the value of such promises to pay of all kinds and sorts which arise from American business.

It must be obvious at once that without a high degree of mutual confidence and trust such a business as that regularly carried on in Wall Street could not possibly exist. Indeed, the money and security panics there in the past have usually resulted from an impairment of mutual confidence and trust rather than from any actual physical destruction of material property by earthquakes, or fire, or warfare. So complete a degree of confidence in each other has been attained there that no one ever thinks of demanding payment in gold coin, although gold is the actual standard money of the country. There is of course a vast gold supply in Wall Street, but it stays hidden in the deep bank vaults there and does not have to be actually employed, since credit provides a perfectly satisfactory substitute. Thus, beneath all the unfamiliar terminology of Wall Street, all its frowning and impressive sky-scrapers, and its elaborate business machinery, lies this basic confidence in the nation and the individuals who compose the nation, without which it could not continue to exist.

III

One of the principal problems which faces those of us whose business consists in handling and estimating credit is the extreme sensitiveness of credit itself. I scarcely need to remind this audience of credit men how quickly and easily credit conditions can be disturbed by the unwisdom of governments, the knavery of individuals or the calamities of nature. The swindling which is going on today through bucketshops and fake securities is a menace to credit. It is an evil of gigantic proportions, but scarcely recognized as such by the people themselves.

Bucketshop keepers and peddlers of fraudulent

securities are—thieves. This may seem to be a superfluous statement but as a matter of fact our loose terminology in the United States prevents the public from identifying as thieves those who are the worst and most vicious of that ilk. Passing along the street if you suddenly hear a cry of "Stop Thief," you are immediately interested and join in the chase. Should the thief be caught you find a certain amount of satisfaction in it. If he receives a stiff sentence in court you applaud the vigorous enforcement of the law. But when you read that a keeper of a bucketshop has been indicted, unless you are one of his victims, you do not visualize an actual crime. It is quite possible that when you are playing golf your partner may quietly remark to you that the fellow driving on the next tee is running a bucketshop. You are curious merely as to the way in which he does business. You do not even inquire, in all probability, as to how he got into the club. You may even find yourself at the same table with him at luncheon. There is no shock to your moral sensibilities. You do not think of him as a sordid thief.

This has always been so. Romances have been woven around the highwayman. Sympathetic novels have been written about his exploits. The man who is arraigned as a common robber, however, is an object of detestation. The robber and the pick-pocket are classed in your mind with thievery, with violation of the law, with a menace to all good citizens. The green-goods man and the confidence man, the security swindler, only excite interest as to the cleverness of their methods and the slickness of their operations. We are as a nation given to euphemism and the substitution of pleasant words for real descriptive terms.

The problem of protecting the investors of the country and safeguarding their money is one of understanding, education and vigorous enforcement

of the laws. All three are necessary. There must be an understanding of the character of the men who run bucketshops and peddle fraudulent securities. They are thieves of the vilest sort. The burglar takes your jewelry and silverware—some of your luxuries. The pickpocket takes your small change. The bucketshop keeper takes your savings. The security swindler robs you of your entire fortune, small or large. The contrast between these classes is apparent but there is no violent public reaction when the bucketshop keeper is exposed. An educational campaign must be carried on among the people of this country and particularly among the investors to enable them to distinguish between safe and unsafe investments. They must be taught to be suspicious of any investment offered to them of which they have no direct and positive knowledge. They must learn to seek expert opinion.

In the matter of law enforcement there is one grave difficulty which District Attorneys experience. The average man or woman who has been swindled is more or less ashamed of his own credulity and will suppress the fact of such swindling from his neighbors or friends and particularly from public officials. Thus the failure of persons swindled to make public their losses prevents prompt action by law enforcing officials. Furthermore in this question of law enforcement the penalties provided are entirely insufficient so far as they apply to the bucketshop thief and the securities thief. It is difficult to convict them and when they have been convicted the penalty is usually a joke. These things are all based on the public ignorance of the real viciousness of the crime and the indifference of legislators in prescribing proper penalties.

In the old days the saloon keeper was invariably a member and an active contributor to political parties. The bucketshop keeper and the security swindler today make it a particular point to keep in

touch with men prominent politically, men who may be useful in interfering with the machinery of justice. I do not doubt that every District Attorney in the country who has been concerned with bucketshop swindling has found at some time or other powerful influences utilized to prevent prompt punishment of the crook. He has found difficulties with witnesses, difficulties with juries, difficulties that seem to spring up from nowhere and evolve out of nothing. All these things have been foreseen by the bucketshop thief who has laid his plans not merely for swindling but for making a get-away either from the police or from the clutches of the law if he is caught.

The victim of the swindler is the man with money to invest—much money or little money—who sets out to improve his financial condition by investment or by speculation. It is an obvious fact that no man would buy a piece of real estate with his eyes shut. He would not select a horse without some knowledge of its soundness. If he buys a motor car he knows something of the make, something of the experience of other owners. It is very seldom that the amateur will buy anything except a standard make. But when it comes to securities there are many persons who feel that they are competent to judge for themselves. If they could realize that experts are often mistaken they would understand the danger of going into such a matter blindfolded.

I object to the idea that the bucketshop keeper and the swindler is concerned only with the small investor and in fact I object to the term "small investor" as generally used. The great accumulations of capital from which railroads are built, great steel plants are erected and operated, trans-Atlantic liners are put upon the ocean, all come from small or comparatively small amounts of money, whether through investments in securities, deposits in savings banks or premiums paid for insurance policies. The

small investor is the average investor. The accumulated money of the small investor makes possible the great investments of the country. For that reason the necessity of safeguarding the so-called small investor or the larger investor is imperative. Accumulated dollars make the millions that develop our country. Nor is it eminently wise for the average man to refer to the small investor as credulous, as a boob, as gullible, as impossible to educate. The poorest investments in the world have been made by wealthy men. There are few estates even today of great volume which have not thousands and possibly hundreds of thousands of dollars of waste paper in the shape of securities.

Let us not belittle the small investor and comment inanely upon his foolishness but rather realize that, proportionately, the small investor is just as wise as the man with vastly more money to invest. There is a considerable proportion of all classes of investors, however, who are susceptible to flattery, too credulous or too gullible, who accept the word of the swindler and lose their money. It is this class of investor—not the small investor but the credulous investor—in whose mind suspicion should be planted and who should be taught to investigate before they invest.

There is a phase of the situation which I would like to emphasize and it deals with this question of investigation. If a man has a thousand dollars to invest and a smooth talking stranger comes to him and offers him a security it is well within the bounds of possibility that the smooth talking stranger will submit references of unquestioned character. It is a fact well within the knowledge of business men in the various cities that it is comparatively easy to get bank references. It is in the records that men who have accumulated say a hundred thousand dollars in swindling have opened an account with a reputable bank and thereafter have referred their

victims to the bank for information concerning them. Too often this bank will look at the size of the deposit and will immediately indicate that the party is all right. The bank means, of course, to convey the idea that financially he appears to be all right but that is taken both as a financial and character endorsement, which often leads to the successful perpetration of unconscionable swindling. There is too great a readiness not only among banks but among men prominent in public life to give endorsements and references.

It is within my personal knowledge, as a Governor of the New York Stock Exchange, that when we tore out the wires from a notorious bucketshop a few years ago, we were deluged with requests from men prominent socially, financially and politically to restore the wires because the firm was in their opinion honest and well meaning. This indiscriminate giving of character endorsements is a menace to every investor whether he be small or whether he be great. You are very likely to take the word of your Senator in giving credit to a man who presents a letter from him, whereas your Senator may know him only as a constituent or as a friend of some other friend.

This question of loose references is not anything new. At the end of the eighteenth century in London there occurred a case of fraud which was based on the ready acceptance of a casual recommendation. To Mr. Martin, a broker on the London Stock Exchange, came a young gentleman of somewhat effeminate appearance, but businesslike and of good address, desiring him to sell £16,000 worth of scrip. Mr. Martin was in the act of courteously explaining that it was usual for a new client to bear some introduction, when the stranger pointed to another well-known broker, Mr. Lyons, who happened to be standing near at the moment. On being accosted, Mr. Lyons readily recommended the

stranger and the recommendation was as readily accepted. Some £10,000 worth of the scrip was sold, but in disposing of the balance it was discovered that the documents were forged. Investigation followed and resulted in the apprehension of Lyons, who pleaded guilty. The stranger—the effeminate client—was his sister. The penalty for this kind of trickery in those days was decidedly severe. The Mr. Lyons referred to in this case was beheaded on conviction.

Let us contrast the strict action of the law in England at that time in the matter of security frauds with the dilatoriness of justice in this country today. In 1762 a stockbroker, John Rice by name, sold out all the stock of a client, a lady, and lost the proceeds in speculation, though for a time he kept up appearances by regularly remitting the dividends. When his breach of trust was discovered he fled to France but was pursued, arrested, extradited and executed for his crime. Can you imagine a bucketshop keeper today who has swindled a widow out of five thousand dollars getting more than six months in jail with time off for good behavior? For the matter of that, can you imagine anyone trying to extradite him from a nearby state or going to the trouble of putting the machinery of the law into force for the sake of a poor widow?

During half a century the New York Stock Exchange has fought the bucketshop evil. It is necessary for a bucketshop to obtain the quotations made on reputable exchanges. Without them they lay themselves open to the suspicion of even their most gullible customers. Therefore they resort to all sorts of tricks to secure these quotations and it has been the persistent fight of the New York Stock Exchange to prevent its quotations from falling into hands where they might be used for criminal purposes. This fight has been extended all over the country and bucketshop after bucketshop has been

driven out of business as well as fraudulent exchanges which were nothing but headquarters for bucketshop operators.

The old system of the bucketshop keeper was merely to take your money, tell you you had bought a certain stock at a certain price, then pocket the money. If the stock went up and you told him to sell you might receive the profit, nominally made, but only up to such time as the profits against the bucketshop keeper were small. Just as soon as the balance was going against him, he closed up shop and disappeared. The new bucketshop keeper purchases your securities actually but immediately sells them out through another account either in his own name or in some fictitious name. The result is the same. He does not hold the stocks which you have purchased.

The peddler of fake securities is, of course, even a more difficult problem. He ignores state laws just as he ignores state boundaries and having established himself in a town he makes a quick clean-up, with the help probably of certain recommendations which he possesses, and leaves for another district. He utilizes all sorts of means and all sorts of tricks which are more or less familiar to the reading public now-a-days. In the meantime there has grown up in nearly all the states stringent laws known as Blue Sky Laws which are being enforced within the limitation of appropriations which are in many cases not particularly large. Those Blue Sky Laws have not eliminated swindling nor could it be expected that they would do so. The laws against murder and arson have not prevented homicide and criminal firing of dwellings.

A year ago I took up with the President of the United States the menace of swindling by means of fraudulent securities. He was tremendously interested and gave me the greatest possible encouragement in the suggestions which I made. Following

these conferences the New York Stock Exchange created a bureau and organized its more than three thousand Members, Branch Office Managers and Correspondents into what might be called an investigating and reporting body. All information which they may secure as to cheats, swindlers and fraudulent promotions are sent to this bureau and there analyzed and brought to the attention of the proper authorities. The services of this bureau are free of cost to any citizen of the United States who seeks our aid. Already hundreds of cases have been submitted. The bureau is working closely with the law enforcing authorities and with the Securities Commissions of the various states. But it requires a nation-wide interest in this question to get full results or to induce people to bring their problems of investment or their problems of swindling to those who are concerned with helping them.

There have also grown up through the country other organizations backed by business men which are designed to cooperate with the law enforcing officials against frauds. There are many kinds of these but I want to refer specifically to the Better Business Bureaus. They are forty-four in number at the present time and really there ought to be four hundred and forty-four. These organizations are run by managers and assistants who are experts in the detection of the crooked proposal and who are familiar with the swindling fraternity. Backing them are business men who give voluntary contributions to the work. Just however as the Blue Sky Law operates in the individual states so these Better Business Bureaus, being more or less isolated, are not able to function fully in a national way. Today there is an interchange of information between them which is exceedingly helpful. There should be a Better Business Bureau in every community unqualifiedly and wholeheartedly supported by the business interests and the patriotic citizens. There should

be the closest possible cooperation between these organizations and the law enforcing authorities, Federal and State.

Recently in Chicago I made the proposal of a national organization to fight security swindlers. Unless the business men of the country undertake to create, or rather support, such an organization, security swindling with its money losses and the cruel suffering which it imposes upon individuals will continue. Unless a definite organization, well supported, nation-wide in scope, cooperative in every sense of the word, backed by the Federal and State authorities and undeviating in its efforts to impose the law upon crooks, is created, this evil of swindling will grow and will threaten the very life of the nation. It is a civic, moral and economic cancer. Again the difficulty in the situation is, I may repeat, that it is not recognized as such by the people.

Let us, therefore, get it definitely in our minds that the bucketshop keeper and the security swindler is a thief—a dangerous thief—and a menace. Let us insist upon law enforcement, the elimination of politics in behalf of these thieves, the simplification of the laws instead of making them more complex and the cooperation of the people with the authorities in the suppression of these crimes and criminals. Let us organize on a national scale and take a vital interest in a national movement to suppress a national menace. The great proportion of business in the United States is sound at the core and possibly five per cent. only is pernicious and dangerous. Is it not worth the effort on the part of the other ninety-five per cent. to clean their houses of all taint of fraud and drive out the criminals who not merely utilize business for criminal purposes but bring business into disrepute and bring danger to the nation?

There is a peculiar responsibility resting upon

the character and initiative of American business today, which arises from this country's pre-eminent position financially in the modern world. The United States for the first time in her history is the leading nation in the world with respect to furnishing capital and credit for foreign as well as domestic enterprises. The world today is looking to this country to lead in the great task of placing currency and credit again on the pre-war gold standard, as well as to restore credit conditions throughout the world which have been so seriously impaired by the war. Flattering as this position of pre-eminence among the nations which our country enjoys is to all of us, it nevertheless entails a deep responsibility, if American business in the future is to prove worthy of its own past achievements. We cannot halt in smug satisfaction that we are today the most wealthy and prosperous nation in the world. We must go forward to make the United States the easiest and safest country in the world to do business in, the country whose credit conditions are on the highest plane, the country which affords the greatest safety for the investment of surplus capital by the wealthy and poor alike. In the past, Americans have been noted for their consistent belief in their country, their fellow-men and their national future. These things are the very heart of sound credit. If our own generation can courageously and persistently follow them into the future, not only will our national and private credit be vastly improved, but the country itself will prove equal to the great financial opportunities which destiny has in the past decade imposed upon her.

FREE MARKETS AND POPULAR OWNERSHIP

*Address before the Forty-first Annual Conven-
tion of the Texas Bankers Association at
Houston, Texas, May 20, 1925*

FREE MARKETS AND POPULAR OWNERSHIP

The interdependence of all sections of our country one upon another is rendered fairly familiar to everyone by the physical movement of goods and merchandise. In the East, we are very generally aware of the fact that a large proportion of our cotton, our oil, and many other of our most important materials originate in your great state of Texas. I have no doubt that here in the Southwest, the importation of Eastern automobiles and other manufactured products is equally recognized. But the constant interchange of capital which goes on daily between East and West is frequently overlooked by everyone except the professional banker, simply because it is an intangible product. Yet this constant shifting of funds from East to West, or from West to East, is an absolutely vital factor to the business and prosperity of the entire country. Hardly a day passes that funds originating in Texas banks do not come into Wall Street to be invested or loaned there on call, while with equal regularity, funds originally accumulated in the Eastern markets are sent out here to develop the vast natural resources and the rapidly developing business enterprises of your state.

It is one of the profound services of commerce to the cause of good government, that steady trade between different sections of America is a most valuable solvent for the misunderstandings between parts of the country which from time to time are apt to arise. So it is, too, with the maintenance of regular financial relations between different sections of the land, except that in this case the process of eliminating misunderstandings is much slower. There

has been, in fact, in all parts of the world and in all periods of history, a special sort of psychology which arises from purely financial relationships, and the attitudes of mind which result from it are worth analyzing a bit.

As long as human nature remains what it is and has been, I imagine that financial creditors will continue to feel somewhat patronizing and dictatorial toward the people who owe them money, while in turn those who are debtors will continue to suspect their creditors and resent any advice from them. For many years the older Eastern sections of this country were creditors in respect of our rapidly growing Western sections, while both East and West were heavily in debt to Europe. The result of this situation was that Europeans were only too ready to volunteer their advice to Americans, who in turn proved very apprehensive of any control from abroad, and tended to suspect "British gold," as it used to be called. At the same time, the East tended to be just a trifle patronizing to the West, which very naturally resented it. Thus, citizens of European nations were more or less unpopular throughout the country, while in the West the New Yorker or the Bostonian was viewed with almost equal suspicion.

Since the War, these economic and financial relationships have been very radically altered, and in consequence the mental attitude of all of us has unconsciously changed with it. Today, the United States is vastly the creditor of Europe, and it is now Europe's turn to resent our somewhat patronizing manner toward her. Recently, during the splendid resumption of gold payment by the British Exchequer, a minority in London expressed grave fears lest Great Britain should now be, as they put it, "dragged at the chariot wheels of American finance." Also, the West and Southwest have in the last decade experienced very remarkable economic progress and are today much more self-sufficient as far as capital

is concerned, and less dependent upon borrowing in the East, than ever before. The Western banker and business man is ceasing to be a debtor of other sections of the country and of the world, and is becoming himself a creditor. The result of this remarkable transformation is, that in the West you are now facing the same creditor problems with which the East has long struggled, and every year you are coming to understand and sympathize more completely with the past and present activities of the Eastern financial centers.

All this only goes to indicate that human nature is everywhere very much the same, and that in the fundamentals people in Texas or New York or even London are very much alike. Not the least advantage to the United States in its great prosperity during recent years, has been the increased understanding which it has brought about between different sections of our country.

II

It is scarcely fair, however, to attribute all of the suspicion so commonly felt in the West, South and Southwest twenty years ago towards Wall Street, entirely to the West's indebtedness to Eastern capital. So rapidly were great business corporations created in this country in the decade after 1900, that in the East no less than in the West, there were natural doubts as to the effects of this swift development in business and finance upon the political and social life of America. Colossal fortunes were suddenly created, great business organizations without precedent developed in the control and ownership of single individuals. It was natural to fear that, if this evolution should continue for another twenty-five or thirty years, our democratic form of government might find difficulty in controlling the essentially autocratic form which American business was suddenly taking.

In recent years, however, a very fundamental and remarkable change has been going on in the actual ownership of the major business corporations of this country. Year after year the number of their shareholders has been rapidly increasing, the large holdings of their stock by individuals have been diminishing, and their shares have been more and more widely distributed among the American public. So far, in fact, has this tendency toward public participation and ownership in the large units of American business proceeded, that today it would be absurd to voice the fears of the growing size of our corporations which many far-sighted Americans expressed only twenty years ago.

Last year the largest American utility corporation—the American Telephone and Telegraph Company—was owned by something like 350,000 different stockholders; our largest industrial company—the United States Steel Corporation—was similarly owned by about 100,000 separate individuals; and one of our largest railway companies—the Pennsylvania—had on its books some 140,000 different stockholders. There is every indication, too, that this same process whereby the stock in large American corporations is being each year distributed among a greater and greater number of people, is still continuing and will continue with, if anything, increasing force. Twenty years ago it used to be possible to speak of the “bloated bondholder,” since bondholders at that time were so few that their average wealth was very high. Today, almost everyone has become familiar with bond investments and the total number of bondholders in this country has multiplied enormously. The significance of this much wider distribution of corporate securities is, that finance no less than business in this country has been vastly democratized, and that the ownership of our large business enterprises has been distributed through all classes and all sections of our population.

This tendency can be observed in bank stocks as well as in the stocks of our railway, utility and industrial companies. We are, therefore, apparently coming into a period when the average American will be a capitalist and security owner as well as an employee, and will in consequence have an especial incentive to become rapidly acquainted with the sound and basic principles of banking and business. In the future, the danger of unfounded but vigorous prejudices against our banks and corporations in all sections of the country will be lessened, and corporate securities themselves will thereby tend to become more sound and stable in value.

III

There have been several fundamental causes for this rapid and widespread distribution of corporate securities over the last ten years. As bankers, I have no doubt that you are all thoroughly familiar with them. Today I merely wish to stress the dependence of this movement upon the efficient marketing facilities of the New York Stock Exchange as the principal capital market of this country, and in some respects of the world. It has not of course been due primarily to the Stock Exchange that our present class of small American investors has been created. Yet without the machinery and the services made available to the public by the Stock Exchange, as well as the many protective features afforded the investor by the Exchange, the astonishing diffusion of security ownership in the past ten years would have been impossible of achievement. Upon some of these protective features established for buyers and sellers of securities by the New York Stock Exchange, I wish to say a few words.

Over a century's experience with the security business has led in the Stock Exchange to the development of a very rigid and severe code of discipline for Exchange members. Applicants are ad-

mitted to membership in the New York Stock Exchange only after searching inquiry into their business records has been made, and their moral as well as their financial solvency is assured. It is by no means enough that an applicant for membership shall have adequate capital—he must also possess those fundamental elements of character which are presupposed in our methods of doing business on the Exchange floor without written contracts or agreements. Furthermore, every Exchange member must submit himself and his business to the severe disciplinary code built up by the authorities of the Stock Exchange over many years. This code of regulations, covering the way business must be transacted on the Exchange, is much more searching and inclusive than even the common law. It is essentially a gentleman's code of honor, rather than simply a set of formal rules. Exchange members can be, and sometimes are, severely punished for offenses of which no court would take cognizance. Far from being unregulated, as it has been sometimes claimed, Stock Exchange members are already more completely and severely regulated as to the conduct of their business by the Exchange itself, than they ever could be by legal process in the courts. The governing authorities of the Stock Exchange have power to suspend or expel from membership in the Exchange any member who transgresses what can fairly be considered to be just and equitable principles of trade.

The New York Stock Exchange is just as particular about the securities admitted to trading in its markets, as it is to the individuals admitted to its membership. Before a security can be traded in upon the Exchange, it must conform to what are known as the listing requirements of the Exchange. These requirements are undoubtedly the strictest and most extensive of any large Stock Exchange organization in the world. The financial structure of the given corporation must be explained in detail,

and complete statements as to its assets and liabilities, and its recent earnings, must be made. For years the New York Stock Exchange has been a leader in the movement to obtain fuller publicity as to the affairs of large American corporations. Even after a security has been admitted to trading on the Exchange, it must periodically publish earning statements and balance sheets in the public press, so that the public can have the opportunity of studying them.

It is important to notice, however, that the New York Stock Exchange never attempts to estimate the value of any security, or even to endorse, guarantee or approve any of its listed stocks or bonds. It has always been felt that such an attempt would be outside the real function of the Exchange, which consists primarily in maintaining a market for securities and rules for the methods of business employed in it. But the Stock Exchange has taken upon itself the task of seeing that enough facts about its listed securities are made available to the investing public for the latter to form an intelligent opinion as to actual security values.

Naturally, all fraudulent promotions and fake stock selling enterprises are immediately and completely barred from the Exchange. But very frequently quite speculative enterprises are allowed to list their securities there. Moreover, it often happens that some old and supposedly established business company will drift into financial difficulties, and its securities, formerly considered in the investment class, will become quite speculative and full of risk. A recent example of this sort has been afforded by the great St. Paul Railroad system, whose increasing business difficulties have been reflected in a tremendous decline on the Exchange in prevailing prices for its securities. In such instances, the Stock Exchange cannot simply wash its hands of the matter by suddenly striking securities of this type from its list, and forbidding further trading in them

there. It has a heavy responsibility to the holders of such stocks and bonds, to maintain a dependable market in them, so that anyone who wishes to sell can avail himself of the ready facilities of the Exchange to do so. In consequence, it by no means follows that all securities listed on the Stock Exchange are desirable investments for everyone, or even that such a listed status indicates a superior investment rating. Yet it is undoubtedly true that listing on the Exchange enables a security to be purchased and sold not only more readily and safely, but usually more cheaply also by the public.

IV

It is the aim of the New York Stock Exchange—and an aim, I may add, which has been realized in practice for many years—to maintain a free and open market for securities. The facilities of this market are thrown open to everyone upon the same basis, and the prices which are made there result directly from buying and selling from all over the country. The Stock Exchange never itself makes prices, or even expresses opinions regarding prices. But on its stock ticker it provides instantaneous and nation-wide publicity to all its open market transactions. No security market in the world gives such complete publicity to the transactions occurring in it as the New York Stock Exchange. A free and open market of this type imposes a severe test upon any security traded in upon it. If there is any real weakness in any listed security, it is very quickly brought to light and reflected in declining prices. In the same way, the less obvious merits of a security are very quickly realized there, and result in rising prices. To the investors of the land, this rough and tumble seasoning process to which our listed securities are subjected is a factor of great value. Investors are able by this means to place their money only in those stocks and bonds which have behaved

well under fire. It is also true that a free and open market like the New York Stock Exchange is in the majority of cases the hardest type of market in the world to manipulate. Any attempt to drive prices above or below true values is immediately revealed on the ticker tape, and a target is set-up for thousands of security traders all over the country to shoot at. Against the collective power of these traders in securities from all over the country, no individual or small group of individuals can hope to take a stand in the stock market.

Many people, while recognizing the value of the Stock Exchange as a market-place for security investors, are inclined to criticize it for the large amount of speculative transactions which occur in it. In fact, the assertion is sometimes made that if this speculative business could somehow be removed, the Stock Exchange market would be a practically perfect mechanism. In actual fact, however, such a view is only a dangerous fallacy. Not only would it be impossible in practice to distinguish clearly and definitively between investment and speculative transactions, but without the powerful support of the speculative element, the purely investment facilities of the Exchange could not for a moment be maintained in their present degree of usefulness and efficiency.

It is particularly important to realize that the distinction between speculation and gambling is quite easy to make, both in theory and in practice. Speculation always involves the transfer of actual property, represents the assumption by traders of the inherent and inevitable risks of commerce and industry, and is furthermore an indispensable factor in affecting distribution between producers and consumers. Gambling on the other hand consists in a mere betting on prices, and the taking of artificially created risks which bear no necessary relation to the ownership of property. This distinction is sound both in

economics and in law, despite the very confused and jumbled thinking and writing on the subject which has frequently occurred. If the New York Stock Exchange should attempt to prevent in its markets all speculative transactions, it would not only fail of its full duties to the public, but it would also tremendously hamper the growth and progress of the country. On the other hand, gambling in all forms has long been entirely forbidden on the floor of the Stock Exchange. If any of you were Exchange members and should try to make bets or wagers there, you would promptly be brought before the Exchange authorities and punished for it.

It is this unfounded confusion of gambling with speculation which has produced the curious result that speculation is so generally condemned in this country, whose growth and progress has always been directly due to speculation in every branch of trade and business. All through American history from the earliest times, this factor of speculation has played its part in making for growth and progress. When, over four hundred years ago, Columbus set forth on his historic voyage of exploration to America, his ships and men were provided for him only as a result of the far-sighted financial speculations of Queen Isabella of Spain. The coming of the Puritans to Massachusetts and of the Cavaliers to Virginia, were similarly financed by the sale of speculative shares in the London stock market, of the London and the Plymouth Companies. When this country finally obtained her independence from Great Britain, her independent status was made financially possible only by the heavy and patriotic speculation in our first 6 per cent. government bonds. Ever since that time, it has been the purchase of speculative securities which has built up the country. The very fact that I could in the last two days come so readily and so easily all the way from New York—over a thousand miles—to this progressive and

rapidly growing Southern business center, is fundamentally due to the steady purchasing of speculative railroad securities in this country over the past hundred years. From the beginning, America has been a pioneer country, and the financing of all pioneer enterprises is bound to involve heavy risk and constant speculation. It is consequently true that speculation is simply a financial aspect of all progress. It is not the stock exchanges that have created speculation, but rather speculation which has led to the organization of the exchanges. Even if all our organized speculative markets should be suddenly abolished, either speculation would still go on or else the progress of the country would halt.

V

It is, however, unfortunate that under the guise of legitimate speculation so many crooked and swindling enterprises continually thrive and flourish. Legitimate speculation represents the attempt of intelligence to deal with uncertainties. But the swindler pretends to carry on a speculative enterprise when actually his motive is not to create new wealth, but simply to steal the shareholder's money. Of course legitimate but risky business enterprises frequently fail, and thus a loophole is often left for the swindler to explain the losses which he himself inflicts upon the public.

As bankers, you are of course familiar with this great and menacing problem of financial fraud. And I think that many of you will agree with me when I state my belief that the solution of the fraud problem lies in the swift and severe punishment of the swindler, rather than in purely preventive legislation designed to make impossible the commission of fraud as such.

The New York Stock Exchange has for many years been interested in attempts directed against financial swindling, and has consistently stood ready

to exert whatever power and influence it has in this cause. We have come to the conclusion, however, that success can be had in this attempt by the drastic enforcement of a few simple laws rather than through the continual passage of new and more or less experimental legislation. Recently, the Stock Exchange established a bureau in its organization, whose function it is to receive all information or complaints regarding security swindling, and to turn these over to the proper county, state and federal officials for active prosecution. Needless to say, any service which the Exchange can render the investors of the country in this way is performed with genuine pleasure and entirely without expense to them. I am in hopes that as time goes on, the security buyers of this country will more and more avail themselves of the services of this bureau, and that through it, working as it does in conjunction with other fraud-fighting groups and organizations, real headway against the continual menace of financial frauds can be made. Accordingly, I bespeak your hearty cooperation to this end.

VI

One basic reason for the need of stamping out financial frauds of every sort is because they so constantly and so gravely threaten our public and private credit, as well as the entire credit machinery of the country. I need not remind this audience of bankers that most financial transactions have long since ceased to depend upon payments in specie or even paper money, and that the deposit credit transferred by check and issued by our banks has become to a very large extent the actual currency of the land. The far-sightedness with which American bankers have developed this economical and efficient practice of paying by check is in strong contrast to the old-fashioned methods still followed in Europe, where for such purposes actual bank notes are gen-

erally used. American finance has been second to none in its adoption of the most scientific and efficient methods of employing credit, and this fact is by no means least among the fundamental reasons for the swift and irresistible growth of the United States.

But the constant employment of credit in its different forms, as it occurs in America, is subject to peculiar dangers. Credit is sensitive—probably more so than any factor in our daily business. It underlies and enters into practically all of our most serious business and personal undertakings. In the crisis of war, our very government is dependent upon the active employment of its credit, to raise through the sale of its bonds the funds needed to assure victory and national safety. Similarly our large-scale corporate enterprises must rely upon their credit, not only to succeed, but to survive. We ourselves, in our individual capacity of investors, regularly part with our life savings in return for stocks, bonds, mortgages and other credit instruments. The economic stability of our American civilization, its fundamental democracy, its ability to reward thrift and enterprise, all rest upon the assumption that credit conditions are sound, and that we can with safety rely upon each other's words and promises to pay. The banker's and the stockbroker's business is thus necessarily and profoundly concerned with ethical considerations, in the absence of which it would inevitably collapse.

As it stands, our credit system more or less supposes that all men are honest and will not attempt to abuse it. Indeed, were this not the situation in the average case, as I have pointed out, no such system could have been developed or could be long maintained. Unfortunately, the fact remains that not all men are honest, and in consequence possible misuses and perversions of the many existing forms of credit must be seriously reckoned upon and as far

as possible obviated, especially by those of us who are professionally engaged in the almost exclusive business of buying, selling and handling credits. The swindler injures not merely the credulous and the uninformed in financial matters. He strikes a deadly blow at the entire basis of our necessary and indispensable business. Whether we desire it or not, we occupy the highly responsible though unofficial position of trustee for the credit conditions in this country, and neither for our own sake nor that of the nation as a whole can we afford to allow the trickery and dishonesty of the financial swindler to long keep any foothold in the financial business of the United States.

Because of its intangible and supersensitive character, the protection and safeguarding of credit is one of the most difficult tasks in the world. We must ever watch our own acts most carefully, to make certain that through carelessness or oversight we do not ourselves unconsciously aid the very fraudulent practices which we are unanimous in condemning. In this connection, I have a concrete suggestion to offer. The rush of American business, the necessity of getting things done each day, has very generally led to the granting of favorable references to all sorts of persons, by very honorable but very busy financial institutions throughout the country. Because it is somewhat awkward to refuse such references, even to people whom we really do not know at all well, we are all apt to give them in order to get rid of the applicant in a courteous way. But this habit, so common in American business, is and has been the source of genuine danger to us all. It is a very disconcerting experience, and one which I have no doubt many of us have at one time or another had, to discover that we have loaned our own good names through carelessness to thoroughly irresponsible and perhaps downright dishonest persons. In the effort to suppress fraud, it is

also disconcerting to find that a large proportion of detected swindlers have in their possession and use constantly, references given them in good faith but overmuch haste by respectable banks and brokerage firms. The granting of such references seems to us a small matter at the time. But unfortunately it has in many cases actually helped the crook and the sharper to ply his nefarious trade. We none of us wish to exaggerate our own importance in the business world, but we must never underestimate it in this particular respect at least.

VII

At the outset of my remarks today, I alluded to the real interdependence which now exists between the various parts of our country. The time has come, it seems to me, when as financial men we must more than ever before view our business aims and problems in a national way. The United States today has suddenly become the greatest financial creditor nation on earth, and this enviable status is a challenge to the constructive abilities of American bankers and financial men, as well as a source of pardonable pride to them. The real history of any nation is written on the ledgers of its banks, its manufacturers, its farmers, and its merchants, as well as upon the statute books of its government, and the future destinies not merely of this but also of many other countries have been placed securely in the hands of American business. If we are to prove equal to the great opportunities thus opening before us, we can scarcely afford to permit the existence of mutual misunderstandings inside our country, or any lack in that ability for mutual cooperation which has already lifted this nation of ours from obscurity to preeminence and power. As American financial men, we must look upon ourselves as trustees for the manifestly great future of this nation.

HOW THE NEW YORK STOCK
EXCHANGE TRIES TO
SERVE FARMERS

An Article in Capper's Farmer, May, 1925

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HOW FINANCIAL MARKETS CONCERN YOU

What do the great financial markets of the United States mean to the American farmer? What service do they render and how does the farmer benefit from it? How do these organizations function, both at home and abroad, in the interest of agriculture and the public generally? These questions and others are answered in this article by E. H. H. Simmons, president of the New York Stock Exchange, one of the greatest financial organizations in the world. The New York Stock Exchange is making a fight on the sellers of fraudulent securities. President Simmons tells about this fight and points out how farmers can help curb and punish these grafters. You will find a great deal of information in this article that is valuable and that you ought to know.—The Editor, Capper's Farmer.

HOW THE NEW YORK STOCK EXCHANGE TRIES TO SERVE FARMERS

Most farmers are kept too busy with their own essential pursuits to study securities or securities markets, while bankers and stockbrokers are likely to eat their three meals a day without giving sufficient attention to the importance of agriculture in general, or to themselves in particular. Nevertheless, the relationship between American agriculture and the securities investment business of the country is and always has been fundamental.

When one studies the history of the United States, the vast debt which all American finance owes to the American farmer immediately becomes apparent. The investment business has to do with directing the surplus wealth of the nation into productive employment. To carry on this important task, banks and stock exchanges have been created in this country, and indeed all over the modern world. But the question then arises—where does this surplus wealth come from? To a minor extent it is drawn from the sea in the form of fish and chemicals, and even from the air as nitrogen and other substances. Yet fundamentally our national wealth has been extracted from the soil in the form of animal and vegetable products, or from the depths of the earth as metallic ores and fuel. Unquestionably the farmer is the greatest producer of wealth in the world. Moreover, since we must all eat or perish, his produce is the most essential form of wealth that exists.

In 1790—only two years before the creation of the New York stock market—about 95 per cent. of the population of this country lived on farms or in farming communities, and only 5 per cent. in towns. Almost the entire energy of our people was thus

required to feed and clothe the population of the country. Today, this distribution of population has been altogether changed, and the inhabitants of American towns and cities now slightly outnumber our farming population. This means that the modern American farmer is growing a surplus of foodstuffs sufficient to feed our city dwellers, and indeed those of other lands. Without such a surplus of foodstuffs, cities could not exist. It has consequently been the surplus wealth created on our farms which has permitted the cities to grow to their present size, and to engage in their present varied industrial and commercial pursuits.

The significance of this constant creation of surplus wealth by American farmers over the last century has been great in respect to the upbuilding of a solid and dependable currency and financial machinery. After the Civil War, the U. S. Government was able to resume gold payments on its inflated paper money in 1879 principally because of the excellent wheat, corn and cotton crops of that year, which were largely sold to Europe at high prices and thus brought back into this country a stream of gold in payment. Likewise in 1896, when the United States adopted the gold standard, the immediate success of the measure was assured by another flood of European gold coming into the country in payment for the excellent American crop exports of that and subsequent years. In more recent times, it has been largely the export of an American agricultural surplus abroad each year that has brought gold into this country, until today the United States has become the wealthiest nation in the world, and a creditor of the leading nations on earth.

It also has been quite generally true that our periods of national prosperity have been inaugurated on the American farm. The farmer quickly shares his good fortune with the city dweller, by purchasing liberally of the latter's goods. In consequence,

agricultural prosperity regularly leads to industrial and financial prosperity, and conversely, agricultural depression is quickly felt in our shops, banks and stock exchanges. In few lines of city enterprise does agricultural depression become more speedily or more keenly apparent than in finance. When the American farmer is in serious difficulties, the earnings and dividends of many large railroad and industrial corporations are reduced, and security prices fall. Credit becomes tied up in "frozen loans." National trade balances are likely to turn against us, and to compel an export rather than an import of gold.

No sensible townsman, surely, can do otherwise than wish the farmer all good fortune, since his own welfare is so basically dependent upon American agricultural conditions. Financial men, while not always understanding the farmers' problems, are of necessity always keenly concerned that they should be successfully solved.

The relationship between agriculture and finance, however, is not wholly one-sided. The farmer too has benefited in many important ways from the organization and growth of the country's financial markets, particularly those of New York. Only by the attraction of funds in small amounts from all over the country into large central reservoirs of capital—a task which for a century our banks and stock exchanges have been performing—has it been possible to construct railways all over the United States, and thus facilitate the shipment to market of the American farmers' produce. The same machinery also lends money to foreign nations, with which to buy American wheat, cotton and other agricultural products. It likewise provides a ready means of changing the foreigner's funds into American money, so that our farmers and planters can readily obtain payment for the shipment of their produce abroad.

In assembling capital for the financing of our great industries and our vast commerce, the work of finance

has also assisted the farmer indirectly by providing him with more numerous and more wealthy buyers of his produce within our own cities and towns. The American farmer's foreign customers are important, yet, after all, the greater part of his output is sold to town dwellers in the United States. Today, for every person living on a farm, there is someone living in an American city or town who must buy food from him. The more modern finance can succeed in averting unemployment in the cities and in raising the standard of living of the townsfolk by installing labor-saving and quantity-production machinery, the more easily agricultural products can be sold in this country.

Finally, the modern investment business has performed another genuine service for the farmer in helping to make available to him a great variety of labor-saving devices and machinery with which to carry on the work on his farm. American cities have, it is true, tended to draw away labor from the farmer in their swift industrial and commercial expansion. Nevertheless, they have largely recompensed him for this, by enabling him to employ in his work slaves of iron and steel in the form of agricultural machinery which has proved a cheap and efficient substitute for vast numbers of manual workers. A fundamental reason why the American farmer is far and away the most prosperous and efficient of all agricultural classes in the world, lies in his employment of machinery.

Hitherto, however, the farmer has not often made it a practice to invest in corporate securities. He has shown a natural preference toward using his surplus funds to acquire more land, or to lend on land mortgages. Indirectly, however, farmers have proved an important class of investors in corporation securities, through taking out insurance policies and starting savings bank accounts, since in both cases the funds which the farmer pays in are regularly

employed to buy and hold corporate bonds. Some farmers have directly invested their savings in corporation stocks and bonds, and not infrequently to their great advantage.

The average farmer is not closely acquainted with the science of security investment, nor very familiar with the financial machinery of the country. As a result he has been only too often victimized by sharpers who are parasites on the legitimate investment business of this country. Many of these crooked salesmen pose as representatives of substantial and conservative financial concerns. The losses to innocent investors occasioned by security frauds run into tremendous sums of money—somewhere between a quarter of a billion and a billion dollars each year.

For many years attempts have been made to check security swindlers. The Federal Government has pursued them through the U. S. Post Office Department and other agencies. The state governments have organized security commissions. The New York Stock Exchange has been in this fight against security frauds for more than fifty years.

Despite all these independent efforts to stop the selling of fraudulent securities, the practice has continued. The reason would seem to be the lack of cooperation hitherto existing between all these separate fraud-fighting agencies. Because of this conviction, the New York Stock Exchange recently has started a new campaign against security swindlers with the idea of getting everyone to join in and help. Hearty cooperation has been promised.

In order to centralize the previously independent efforts made to check venders of fake securities, the Stock Exchange has set up a special department to serve as a sort of clearing house for information on security swindling. Already this department has begun to function. Incidentally, readers of Capper's Farmer are heartily invited to inform the New York

Stock Exchange concerning any suspicious cases in connection with security sales that may come to their attention. All such letters will be considered confidential, and every effort will be made to investigate the cases they mention, and to prosecute evil-doers.

It is possible that new legislation might in some cases help to check the fraudulent security salesman. But it is of more fundamental importance that the many good laws already on the statute books relating to swindling, be consistently and unsparingly enforced. This effort to enforce our fraud laws and to put the swindling security salesman out of business is obviously to the interest of the American farmer as well as to the city dweller, and it is to be hoped that agriculturists no less than townsfolk everywhere will lend to it their full cooperation.

THE STOCK EXCHANGE AND THE PEOPLE

*An Interview by W. S. Cousins, Financial Editor,
International News Service*

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THE STOCK EXCHANGE AND THE PEOPLE

Editor's Note—The functions of the Stock Exchange; its operations and methods; pool operations in the stock market; fictitious or "wash" sales; short selling and other topics of interest to the public are discussed in an exclusive statement for International News Service by E. H. H. Simmons, President of the New York Stock Exchange.

Mr. Simmons' answers appear in a series of four articles.

By W. S. COUSINS

Financial Editor, International News Service

ARTICLE NO. 1

The Function of the Stock Markets

Does the Stock Exchange perform any essential economic function that could not be better performed by other agencies—the banks and investment bond houses, for example? Do you consider its main function speculative, or an aid to investment buying?

There are many important economic functions performed by the Stock Exchange which could not be performed with anything like the same efficiency, reliability or satisfaction to the public by the unorganized "outside market" between banks and investment bond houses. Of these functions the principal are: (1) The establishment of reliable, close and completely competitive security prices, and their instant distribution all over the country through the stock ticker system; (2) the severe regulation of methods of purchasing and selling securities, and the ability of the market as a whole to discipline unfair actions by any of its members; (3) the superior ability of the Exchange to maintain its markets during periods of economic pressure, compared with the tendency of the "outside market" to suspend

at such times; (4) the superior negotiability and availability for collateral purposes conferred by the Exchange on its listed securities; (5) the greater relative equality established on the Exchange between large and small buyers and sellers; and (6) the greater amount of information concerning corporate securities made available to investors by the listing requirements of the Exchange.

A stock exchange here, or elsewhere, represents merely a higher form of organization for marketing securities than that developed through unrestricted trading between individual houses. Because of their obviously superior services to the public, stock exchanges have increased in numbers and scope everywhere in the world by a natural process of evolution. There are now over 200 stock exchanges in the world, and over 20 in the United States alone.

The New York Stock Exchange of today is the result of a natural economic evolution extending back to 1792. It has never enjoyed any legal, economic or other monopoly in the business of security marketing. Transactions on its floor are at all times completely subject to severe competition from other security markets all over the world. Investors and speculators do business through the Exchange only because they obtain there superior service at minimum costs. When, as sometimes happens in active securities, the "outside market" can render services superior in any way to those afforded by the Exchange market it immediately will obtain the bulk of the business.

The processes of investment and speculation in securities are in practice so inter-related that no such sharp distinction between them as is implied by your question can in actual practice be established. The fundamental and basic function of the Exchange is, of course, to distribute securities to investors and provide a ready market for their re-sale. But as a necessary part of this mainly investment process, it

must also enable securities to be "seasoned" and held ready for sale to investors, and this task is performed mainly by speculators. Neither process is or can be independent of the other. Both are undoubtedly facilitated by the Exchange. Of course a large proportion of transactions on the Exchange are speculative. But it is incorrect to assume that stock exchanges have created speculation; as a matter of fact it has been speculation, along with investment, that has created stock exchanges.

ARTICLE NO. 2

Encouraging or Restricting Speculation

Do not the Stock Exchange members encourage unwarranted speculation by many people who cannot afford to and therefore should not indulge in margin stock trading?

a. By colorful descriptions of industrial companies in "house organs"?

b. By maintaining "branch offices" where the man with only a few dollars is induced to go beyond his depth?

c. By the activities of "customers' men" who urge the buying of speculative stocks in order to earn commissions?

An examination of the constitution of the New York Stock Exchange readily reveals the fact that the Exchange has for many years consistently forbidden its members to unduly encourage the public to speculate in securities. Exchange rules of long standing prescribe minimum rates of commission which cannot be lowered by members in a dangerous and excessive competition for business. Adequate margin in all cases is required. Advertising by member firms is rigidly restricted and frequently censored, to avoid anything resembling the publication of tips or unfounded rumors, likely to affect market prices. Moreover, it should be recognized that stock brokers' losses through bad accounts may at any time greatly exceed the small commissions charged upon Exchange transactions. If only for their own safety, Exchange members cannot afford to accept business likely to impose such heavy losses upon themselves.

Until the millennium arrives and we find ourselves living in Utopia it will, of course, be in practice impossible for the Exchange to enforce many of these restrictions to absolute perfection. Furthermore, the Stock Exchange cannot, and should not even attempt, to assume the function of determining who should or who should not speculate, or of denying the facilities or its free and open securities market to the public on any theoretical or arbitrary basis. Nevertheless, it is a matter of record that the Exchange

not only wishes to avoid facilitating unwarranted speculation, whether by its own members or the public, but has exercised its powers of discipline over its members in this connection consistently and severely.

Sometimes too Optimistic

a. There is some justice in the charge that "house organs" and market letters of Exchange firms occasionally indulge in "colorful descriptions of industrial companies" which are not ultimately warranted by the facts. But unless misinformation is thereby conveyed, such "descriptions" are after all only opinion, and should be accepted as such by their readers. In any case, such "market letters" go almost entirely to established customers of the issuing firm, and are therefore in the nature of private correspondence rather than public advertisements.

Undue optimism often leads to financial losses in any business, and is a tendency which exists throughout all American business. If over-confidence in the future of American business is a crime, the whole American people must be indicted. Undoubtedly stock brokers, like every one else, err occasionally in this direction. Yet the harm done by brokers' opinions is small compared with that sometimes done by corporate executives who during industrial depressions issue misleadingly cheerful statements. Neither the New York Stock Exchange nor any similar organization in the world can undertake to pass upon the correctness of opinions or prophecies regarding the future. But the Exchange provides severe punishment for its members in cases involving the spreading of mere rumors designed to affect market prices. It makes every effort compatible with its actual powers in the really fundamental matter of seeing that frequent and complete financial and earning statements of listed corporations are made available to everyone through the press.

Branch Offices Affected

b. The maintenance of branch offices is not in itself any more likely to result in "unwarranted speculation" than that of any other type of office dealing in or handling transactions in securities. As far as the customer in a branch office is concerned, a branch office manager may through self-interest take his part in any misunderstanding with the Exchange, even when such an attitude is quite unjustified. It is naturally true that in an organization like the New York Stock Exchange system, with branches all over the country, a few branch office managers may fail adequately to understand the Exchange's machinery and its rules, or to explain them clearly to customers. In order to rectify possible unfortunate cases of public misunderstanding from this source, the Exchange in recent years has held annual conventions in New York for out-of-town partners and branch office managers, with the purpose of informing them at first-hand concerning the operations, rules and standards of commercial practice which it maintains.

c. Brokerage firms are engaged in the business of selling service to their clients; as in almost every other business, this work requires salesmen, who are known as "customers' men." Thus far, certainly, no especial fault can reasonably be found with the brokerage business. Undoubtedly "customers' men" have the same desire to secure business as other salesmen, and sometimes the same tendency to show more enthusiasm than exact knowledge or wise judgment. Of course, Exchange houses should and mainly do clearly recognize the necessity of carefully supervising the work of their "customers' men" in their own interest and that of the public from which their business comes. Many rules of the Exchange are and have long been directed at this very problem. Improvement is still possible, yet existing conditions

and standards are by no means such as to deserve careless or sweeping denunciation.

It is a fact that most customers who open an account with a broker do so to speculate rather than invest. The "customers' men" cannot alter this old tendency, which only reflects the swift progress of our country, and the inevitably rapid changes of value in our business enterprises, compared with older, poorer and less progressive countries. In any case, the "customers' man" who consistently urged clients into unusually speculative transactions would under the laws of the Exchange receive no part of the resulting commission himself, and would not last long in his vocation.

ARTICLE NO. 3

Pool Operations in the Stock Market

Is not pool operation a menace to security values, and should not the Stock Exchange authorities take more vigorous action against professional or pool manipulation of stocks?

"Pool operations" is a catch-phrase capable of various interpretations according to its application to different individual cases. There are many kinds of so-called "pools," although the number operating in the market at any given time is as a rule greatly exaggerated. Almost always they are conducted by non-members of the exchange.

As the term is generally used, it refers to joint speculation by two or more persons in a given security or securities, and with or without an intention to manipulate prices. But in any case, when pool activities occur in the Stock Exchange market, the rules of the Exchange effectually prevent them from being accompanied by fictitious transactions. The buying and selling involved come out publicly on the stock tape, where every one can see it and make up their own opinion concerning it.

Except in the case of syndicates marketing recently issued securities, the purpose of a "pool" is to gain a difference between the buying and the selling price. In consequence, pool operations obey the general economic laws which govern any other kind of speculation. One of the greatest security operators in the history of Wall Street used to say that "Everybody is greater than anybody." No syndicate is strong enough to oppose successfully the vast and powerful "trends" of a national public market like that provided by the Exchange. In consequence, the success of a "pool operation" depends more upon wise foresight as to future economic conditions than upon the mere dead weight of the "pool's" financial resources. If prices are moving up for substantial economic

reasons, a pool can often buy cheap and sell out at higher prices with a resultant profit; as far as its purchasing tends to raise prices, this only increases the efficiency of the stock market in more quickly discounting future conditions. But if such an operation is attempted when prices are inevitably falling, the effort is practically foredoomed to failure. Undoubtedly the operations of pools, as of individual speculators, sometimes result in temporarily over-high prices, but instances of this sort occur in securities whose future value is difficult to estimate, and where hind-sight is vastly easier than foresight. An apparently undue advance in price of a "pool stock" quickly leads to selling until the price declines to its more probable value. To be successful, pools, like individual speculators, must accomplish that most difficult feat of accurately forecasting the future.

Far from facilitating pool operations of the undesirable and uneconomic sort, the organized securities market is the most important and most effectual check upon them, because of the swift and complete publicity given to transactions within it, and the nation-wide interest which it attracts. The "pool" which attempts to oppose the dominant economic forces in the market simply makes itself a target for security traders all over the country.

It is not the function of a stock exchange to regulate or arbitrarily interfere with prices made upon it, but simply to furnish a free and open market where prices can be made by the public under the fairest and most carefully safeguarded conditions. Provided that the market remains free and open, normal speculative forces will automatically check their own occasional excesses, and interference in such processes by the Exchange would be not only uncalled for, but probably harmful to the real interests of the public.

ARTICLE NO. 4

"Wash Sales" and Short Selling

Does the Stock Exchange prevent "wash sales," and are all reported sales of stocks on the Exchange genuine? Is the claim of Judge Gary and other industrial leaders that reported sales are often fictitious based on fact?

Fictitious transactions in securities were forbidden in the Stock Exchange Constitution as far back as March 15, 1817. Subsequently, they were similarly forbidden by the laws of New York State. It is possible that in rare and isolated cases "wash sales" of stocks still occur, owing to the impossibility of the Exchange's checking up every single transaction in its market, and to the possibility of Exchange members being used as brokers to effect such transactions without any knowledge of the fact. However, this is a merely hypothetical case. For all practical purposes it can be confidently stated that "wash sales" on the Exchange do not exist. No industrial leader with an adequate knowledge of the Exchange or its practices could ever make the statement that the sales occurring on its floor are fictitious.

The reporting of Stock Exchange quotations on its stock ticker tape is, like any such mechanical process, subject to occasional errors, which are, however, practically always detected and corrected at once. From the ticker quotations newspapers compile sales reports in which a certain percentage of errors can scarcely be avoided, owing to the pressure under which this news must be collected, tabulated, set in type, proof read and printed. The Exchange naturally cannot state that all sales on the Exchange reported in the press are "genuine" as long as any errors in the reporting system are possible.

Does not short selling of stocks tend to undermine public confidence in security values and the industry they represent; cannot short selling be easily detected, and should not measures be taken to prevent it in times of national distress, when people are easily frightened into selling securities below their real value?

Short selling undermines public confidence in security prices only when such prices fail in fact to deserve it. Any one who sells short a security whose price deserves to rise will lose his money; in consequence his activities in this direction are always limited by purely economic and financial considerations. On the one hand, the short seller's operations serve to lower prices unduly high, and on the other to support prices at a lower level by purchasing to "cover."

The statement sometimes made that a decline in the price of a stock affects the industry represented by the stock in a casual way is pure absurdity. The assets, earning powers or even the credit of a company are not affected by the daily speculative fluctuations of the company's securities. Changes in them are not produced by stock fluctuations; on the other hand such changes are the cause of important fluctuations. To blame declining stock prices for industrial depressions is to utterly confuse cause and effect.

Someone has rather pointedly remarked that the stock market tells the truth in moments of popular delirium. It is natural that such a habit should make the market unpopular in certain quarters. As recently as this Spring, there was more or less criticism of short selling, "bear raiding" and what-not by industrial leaders and financial writers. But the ensuing slump in business, of which the downward movement in industrial stock prices was merely a correct forecast, has very effectually put an end to such unfounded complaints against the securities market.

As the editorial columns of the New York American for June 28, 1924, have accurately pointed out:

"The movement of prices on the New York Stock Exchange is an almost infallible guide to the coming business prosperity or depression of the country.

"So delicate and sensitive is the Stock Exchange's

nation-wide and world-wide system of news gathering and so skilled are its operators in estimating the future that stock prices generally give a six months' or nine months' warning of what we have before us. The present slump in business was accurately foretold by slump in stock prices which began in March, 1923, and ran until late last Fall. All this time business was booming. Industrial employment was full and railroads could not carry the tonnage offered them. What was the matter with the stock market? It was predicting what was to come. And it predicted right.

"The Federal Reserve Board's summary, just out reports that the index of production in basic industries is 18 per cent below the peak reached a year ago. The value of building contracts is 13 per cent less than in April, and in May the figures of industrial employment fell another 4 per cent below the low figures of April."

It is sometimes forgotten that the majority of speculative losses in the stock market are caused by purchasing at too high prices. By holding the rising tendencies of the market within reasonable bounds, the short seller tends to minimize losses of this character.

On the floor of the Exchange short sales are made like any other kind of sale, just as margin purchases are made there like any other purchase. Not all short sales are speculative anyway; some resemble in a general way "hedges" in the commodity markets, while others represent outright selling from distant points.

In extreme cases of national distress to check short selling would be a false remedy worse than the disease. It is well known that in such panic markets practically the only buying power is represented by previous short sellers who are buying to cover their short commitments. Far from aggravating panics, short sellers are actually the leading factors in relieving them. Moreover, a grave administrative responsibility would be involved by such a program. Who is to determine what the

“real value” of securities is at such times, and upon what basis? Of what actual use would such an estimate of “real value” be, however carefully and skillfully determined, if buyers refuse to purchase at the prices thus estimated? However wise the few individuals to whom power would have to be entrusted to regulate short selling in any such fashion, they are not as wise as the whole public. “Everybody is greater than anybody.” The public has infinitely more to fear from the arbitrary actions of a few men in artificially “regulating” this and that on the Stock Exchange than from the financial power and resources, the average judgment and courage of the whole people of the country. Much the same experience which in government has led to the spread of democracy and the abandonment of autocracy has also resulted in an increasing realization of the public danger of narrow, limited and private security markets, and the national and individual advantages derived from the free and open markets of the type maintained upon the New York Stock Exchange.

note - 5

